

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

BRIEF FOR RESPONDENT

IN THE
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA
UNITED STATES
COURT OF APPEALS FOR THE
DISTRICT OF COLUMBIA

No. 8394.

FILED MAR 13 1943

IN THE MATTER

of

ENGINEERS PUBLIC SERVICE COMPANY

and

ITS SUBSIDIARY COMPANIES

23

ENGINEERS PUBLIC SERVICE COMPANY, et al.,
Petitioners,
against

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION TO REVIEW ORDERS OF SECURITIES AND EXCHANGE COMMISSION.

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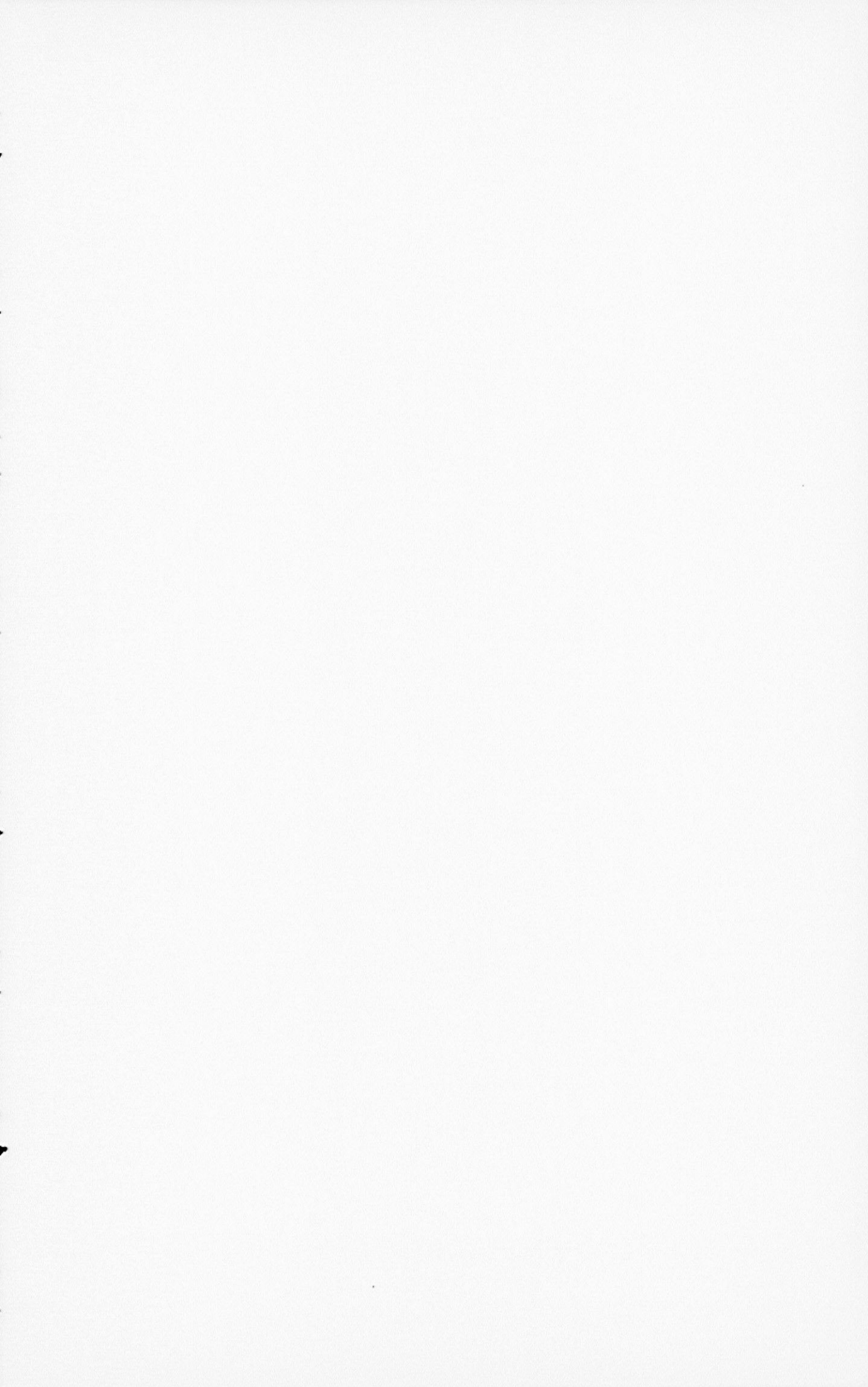
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COUNTER-STATEMENT OF THE CASE

The Appeal

This case comes before the Court on a petition of Engineers Public Service Company and certain of its subsidiary companies to review two orders of the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935.¹ The petition to review was filed pursuant to Section 24(a) of the Act as expressly permitted by Section 11(b) thereof. The orders of the Commission complained of by Petitioners were issued under Section 11(b) (1) of the Act and required Engineers to divest itself of certain properties and interests.

The Engineers Holding-Company System

Engineers Public Service Company registered as a public-utility holding company pursuant to Section 5 of the Act on February 21, 1938. It was incorporated in Delaware in

¹ Act of August 26, 1935, c. 687, 49 Stat. 803 to 838, 15 U.S.C. 79 to 79z-6. Hereafter the statute involved will be referred to as "the Act". For the convenience of the court copies of the Act are submitted with this brief. Sections of the Act are referred to as numbered in these copies.

In this brief the following abbreviated references will be used:

Engineers Public Service Company—"Engineers"

Virginia Electric and Power Company—"Virginia"

Gulf States Utilities Company—"Gulf"

El Paso Electric Company (a Texas corporation)—"El Paso"

El Paso Electric Company (a Delaware corporation), a registered public-utility holding company—"El Paso (Del.)"

The foregoing companies, together with Engineers' other subsidiaries in this proceeding, are sometimes referred to as "Petitioners". Respondent will be referred to as "the Commission".

1925 and has its principal offices in New York City. None of its subsidiaries conducts its operations in Delaware or New York. Engineers controls gas and electric utility companies which serve widely scattered sections of the country. Electric service is furnished in the States of Virginia, North Carolina, Florida, Georgia, Louisiana, Texas, New Mexico, Washington, Wyoming, Missouri, Iowa and Kansas. Gas service is rendered in Virginia, Louisiana, and Washington by the subsidiaries which render electric service in those states.

In addition to operating these gas and electric facilities, the subsidiary companies in the Engineers system also engage in various non-utility businesses.² Thus, they operate bus and street railway systems, interurban and suburban transportation lines, toll bridges, ice and cold storage plants and various water, steam and telephone enterprises in fourteen states, Canada and Mexico. Many of them sell electric and gas appliances. The entire holding-company system uses and bears the cost of service furnished by Engineers Public Service Company, Inc., a mutual service company, organized and having its executive offices in New York, the stock of which is owned by the holding company's several subsidiaries. Engineers also owns a stock interest in a non-subsidiary natural gas company (Pet. App. 53, R. pp. 9537-38). Maps indicating the location of the system properties are appended as Exhibits 1, 2 and 3 to the Brief.

The Engineers system thus operates in a widely spread territory. It rendered electric service to 440,000 customers in areas having populations amounting to over 2,500,000

² Unless the context otherwise requires, the terms "utility", "public utility", etc., as used herein, are confined to the two types of public utility to which the Holding Company Act applies—electric and gas utilities. A transportation system, a water system, or a toll bridge is, for the purposes of the Act, a non-utility business, and will be so treated in this brief.

(R. p. 9563).³ It has 21,300 stockholders (R. p. 9560). A consolidated balance sheet of Engineers and its subsidiaries as of December 31, 1940 carries the system's assets at nearly \$375,000,000 (R. pp. 9551-52). In the order of their importance as measured by their net income for 1940, the principal subsidiaries of Engineers are Virginia Electric and Power Company, Gulf States Utilities Company, Puget Sound Power & Light Company and subsidiaries,⁴ and El Paso Electric Company (Del.) and subsidiaries (R. p. 9562).

The executive offices of Engineers, in New York City, are separated from the areas served by its electric and gas utility subsidiaries by distances ranging from 375 miles to 3,100 miles (Exhibit 3 to this Brief).

Engineers' relation to its subsidiaries is not confined to a passive holding of their securities. It exercises active control over them. By virtue of its voting power, which ranges from 65% to 100% in the several subsidiaries,⁵ it elects their boards of directors. It designates their executive officers and transfers them from one subsidiary to another.⁶ In the protection of its investments Engineers, through the medium of the service company, all of whose principal officers occupy identical positions in the holding company,⁷ arranges for the financing of its subsidiaries;⁸ negotiates for their bank loans and the sales of their securities;⁹ reviews the contents of their reports to regulatory bodies and tax authorities, although these are initially prepared by the sub-

³ The divestment of most of the properties of The Western Public Service Company (Md.) in January, 1942, reduced these figures to about 420,000 customers in a population of about 2,440,000 (R. p. 9563).

⁴ The relative importance of Puget to Engineers is considerably diminished by reason of its substantial accumulated arrears in preferred dividends (R. p. 9585).

⁵ R. p. 9559.

⁶ Pet. App. 455, 566-67, 609, 632, 690, 710.

⁷ R. pp. 3971, 9535, 9770.

⁸ Resp. App. 57.

⁹ *Ibid.*

sidiaries themselves;¹⁰ prepares and distributes reports to stockholders and information about the system for general publication;¹¹ and generally supervises their financial, operating, accounting and construction matters.¹² In a very real sense Engineers dominates its subsidiaries.

The Statute

Section 11 (b) (1) of the Act provides:

“(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

“(1) to require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system: *Provided, however,* That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

“(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

“(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

“(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and

¹⁰ Resp. App. 9-11, 59, 61.

¹¹ Resp. App. 57.

¹² Resp. App. 1, 57-63; R. p. 9565.

the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

"The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one or more integrated public-utility systems the retention of an interest in any business (other than the business of a public-utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems."

The Proceeding Below

The Commission on February 28, 1940, instituted this proceeding by notice of and order for hearing to determine what action was necessary to limit the operations of the Engineers system in conformity with the provisions of the statute (Pet. App. 166-180).

After hearings, the Commission found that under the Act Engineers, if it retained the electric system of Virginia, could not retain the electric systems of Gulf and El Paso (Del.). Having found that the electric properties of Virginia and Gulf were not both retainable by Engineers, the Commission agreed to grant Engineers' request for advisory findings as to which properties were retainable on the alternative assumption that the electric system of Virginia would be retained or that the electric system of Gulf would be retained (Pet. App. 275-278).¹³

Accordingly, after further hearings, the Commission, on September 16, 1942, found that the electric utility sys-

¹³ At this time the Commission ordered Engineers to divest itself of Puget Sound Power & Light Company and its subsidiaries and of The Key West Electric Company, and found that divestment was also required of The Western Public Service Company, a Maryland corporation and itself a registered holding company (Pet. App. 275, 287, 296-297).

tem of Virginia, its electric appliance merchandising and jobbing business, and its ice business could be retained under the Act, and the Commission entered its order requiring Engineers to dispose of its ownership and control of securities and properties of Savannah Electric and Power Company, Gulf, Baton Rouge Bus Company, Inc., El Paso (Del.) and its subsidiaries—El Paso and El Paso and Juarez Traction Company—El Paso Natural Gas Company, Engineers Public Service Company, Inc., and the gas utility system, the gas appliance merchandising and jobbing business and the transportation properties of Virginia. The order permitted Engineers to petition for leave, within fifteen days, to retain Gulf's electric utility system instead of that of Virginia, and the findings and opinion indicated the properties which could be retained and which were required to be divested under the Act in that event.

The operations of El Paso (Del.), a holding company subsidiary of Engineers, were limited to the electric utility systems and the appliance business of its subsidiary, El Paso, and the order required El Paso (Del.) to divest itself of the transportation and toll bridge business of El Paso and El Paso and Juarez Traction Company.

This order of September 16, 1942, described in the preceding two paragraphs, is the first of the two orders of the Commission of which Engineers and its subsidiaries seek review in this Court (Pet. App. 78-162).

The second of the two orders, dated October 6, 1942 (Pet. App. 163-165), was on a petition for a rehearing in which petitioners repeated their proffer of evidence addressed to the constitutionality of Section 11(b)(1), requested the right to introduce additional evidence, and requested a stay. The petition was denied, with the exception of another 15-day period which was granted to Engineers in which to petition for leave to retain the electric utility system of Gulf instead of Virginia. No such petition for the retention of Gulf was filed.

Since the first divestment order in these proceedings, on July 23, 1941, Engineers has taken steps toward complying with several of its provisions. It has divested itself of its interest in The Western Public Service Company (Md.) and practically all of that subsidiary's properties. It has undertaken negotiations for the sale of its interest in The Key West Electric Company. Engineers has filed a plan for the recapitalization of Puget Sound Power & Light Company, a third subsidiary, for the avowed purpose of facilitating its disposition by Engineers. Engineers has petitioned the Commission under Section 11(c) of the Act for an extension of the period for compliance with the divestment order with respect to The Key West Electric Company and Puget Sound Power & Light Company. Neither of these two subsidiaries nor The Western Public Service Company (Md.), which has been dissolved, appears as a petitioner in the case before this Court.

SUMMARY OF ARGUMENT

1. The Commission properly ordered Engineers to divest itself of the electric utility systems of Gulf and El Paso.

Section 11(b)(1) limits a public-utility holding company to a single utility system, and permits it to retain additional utility systems and other non-utility businesses only where they conform to the specifications set forth in the statute. Clause (B) of Section 11(b)(1) bars the retention of any additional utility system unless it operates in the State of the single utility system or in an adjoining State. This construction of Clause (B) is required by its legislative history, by the announced policy and purposes of the statute as a whole, and by the impractical and irrational consequences resulting from any alternative construction. Since Clause (B), as construed by the Commission, thus limits the permissible scope of a holding company's utility operations to the area close to its principal system, and since the Gulf and El Paso electric systems are remote from that of Virginia, Engineers cannot retain the Gulf and El Paso electric systems with the Virginia electric systems.

2. The Commission properly ordered Engineers to divest itself of the Virginia gas system.

Clause (A) of Section 11(b)(1) bars the retention of any additional system unless a loss of substantial economies is shown to result from its operation independently of the holding company. On the facts presented by petitioners, the Commission was unable to find that such loss of economies would in fact occur if Virginia's gas system were separated from its electric system. It found that petitioners' claims of increased expenses resulting from such severance were exaggerated, and that petitioners had not considered the countervailing advantages which would result from independent operation. Since the statutory standard was not met, the

Commission correctly ordered the divestment of the gas system.

3. The Commission properly ordered Engineers to divest itself of the transportation properties of Virginia and El Paso.

Section 11(b)(1) provides that non-utility businesses may not be retained unless they are "reasonably incidental, or economically necessary or appropriate to the operations" of a retainable utility system. The legislative history of the Section supports the plain inference of the language and not the contrary contentions of petitioners. The Commission found that certain of such businesses were so related to the operations of the Virginia and the El Paso electric systems, respectively, and could, therefore, be retained with them. On the other hand, the Virginia transportation business and the El Paso transportation and toll-bridge businesses were not related to the operations of the respective utility systems. Their combined operations, furthermore, produced results detrimental to the interests of investors and consumers. The Commission was unable to find that the retention of these non-utility businesses met the statutory test.

4. The Commission entered no order on the assumption that Gulf's electric system was to be Engineers' principal system. There is, therefore, no order before the Court on the question of whether Gulf's gas system and non-utility businesses in the Gulf area may be retained in addition to its electric system. It is clear that the gas system and non-utility businesses in the Gulf area may not be retained with Virginia's electric system.

5. The Commission had power to designate Virginia's electric system as the single system which Engineers could retain, since petitioners had refused to designate the electric system of Gulf as the single system. The statutory provision authorizing the Commission to modify its order under

changed circumstances serves to protect such rights as petitioners may have, should it become advisable to dispose of the Virginia electric properties and retain those of Gulf.

6. Section 11(b)(1) is constitutional.

The section is a proper exercise of the commerce power. It applies only to holding companies whose activities and functions in the surveillance and management of their subsidiaries are inextricably linked with the facilities of interstate commerce. Engineers is such a holding company. The section bears a reasonable relation and provides an appropriate remedy for holding-company abuses which, after exhaustive studies, the Congress found affect interstate commerce.

The statute does not violate Due Process. It is not confiscatory, and the choice between divestment and other remedies was for Congress to make. Petitioners have proffered opinion evidence addressed to the constitutionality of Section 11(b)(1). The material is not of such a nature as to contradict the Congressional findings and cannot affect the constitutionality of the statute.

ARGUMENT

POINT I—THE COMMISSION'S ORDER IS
SUPPORTED BY THE RECORD.

The petition involves numerous questions relating to the construction and constitutionality of Section 11 (b) (1) of the Public Utility Holding Company Act of 1935. With one exception all the major questions of law involved in the present petition were presented to and decided by the Circuit Court of Appeals for the Second Circuit in the case of *The North American Company v. Securities and Exchange Commission*, — Fed. (2d) —, decided January 12, 1943. The exception is the question relating to the retainability of the Gulf and El Paso electric utility systems with the Virginia electric system which is discussed in A, *infra*. Certiorari has been granted in *The North American* case (March 1, 1943), but The North American Company did not raise in the petition for certiorari any of the questions of construction urged in the Circuit Court and it relies exclusively on the contention that the Act is unconstitutional.

A. THE GULF AND EL PASO ELECTRIC PROPERTIES ARE NOT
RETAINABLE AS ADDITIONAL SYSTEMS WITH THE VIR-
GINIA ELECTRIC SYSTEM.

Section 11 (b) (1) requires limitation of the operations of a holding-company system to a single integrated public-utility system. The only exception relating to utility operations permits the retention of "additional" integrated public-utility systems if it is established that the additional systems bear certain operational and geographical relationships to the "single" system.

The Commission found that the electric utility properties of Virginia (located in Virginia and North Carolina), Gulf (located in Louisiana and eastern Texas), and El Paso (located in western Texas and New Mexico) each consti-

tuted an integrated electric utility system. The Commission's order under Section 11(b) (1) permits Engineers to retain only Virginia and requires it to divest itself of Gulf and El Paso. A brief consideration of the background of the statute requires the conclusion that Section 11(b) (1) limits a holding company's operations to a single restricted area, and does not permit operations in the scattered areas covered by the Virginia, Gulf and El Paso electric systems.

The bill which originally passed the Senate (S. 2796, 74th Cong., 1st Sess., 79 Cong. Rec. 9065, June 11, 1935) required the complete elimination of holding companies except in situations where the Federal Power Commission should issue a certificate finding that the continuance of a holding company was necessary. The House modified the bill and adopted a substitute which directed the Securities and Exchange Commission to order holding companies and their subsidiaries to limit their "operations . . . to a single integrated public-utility system, except that if the Commission finds that it is not necessary in the public interest to so limit the operations of such holding-company system, the order of the Commission shall require such company to take only such action . . . as the Commission finds necessary to limit such operations to such number of integrated public-utility systems as it finds may be included in such holding-company system consistently with the public interest." (S. 2796 79 Cong. Rec. 10637, July 2, 1935; cf. H. Rep. No. 1318, 74th Cong., 1st Sess., June 24, 1935).

Conferees of the House and Senate worked out a substitute bill which was enacted as the Public Utility Holding Company Act of 1935. The Conference Report made it plain that additional integrated systems were to be retained only if it were affirmatively shown that, among other requirements, all of the integrated systems—both the principal system and the additional systems—were located in the same State or States or in adjoining States or a contiguous foreign country. The Conference Report summarized this history of Section 11(b) (1) and stated:

"It may be observed that section 11 (b) in both the Senate bill and the House amendment contemplates the reestablishment of the advantages of localized management in the operating utility industry and the consequently necessary breakdown of the control of large holding companies over geographically scattered operating utility companies. Section 11 of both bills, therefore, authorizes the Securities and Exchange Commission to require a holding company to limit its control over operating utility companies to one integrated public-utility system.

"To this limitation the Senate bill, like the House bill, allows in section 3 exceptions in the case of a holding company whose interests are essentially intrastate and in the case of a holding company whose interests are essentially foreign. The House amendment grants what amounts to a further exception when the Commission finds that more than one integrated system may be included in a holding-company system 'consistently with the public interest.'

"The conference substitute meets the House desire to provide for further flexibility by the statement of additional definite and concrete circumstances under which exception should be made to the form of one integrated system. Definite exceptions not only provide a satisfactory constitutional standard but also an effective standard for the guidance of both the Securities and Exchange Commission and those holding companies which wish voluntarily to comply with Congressional policy.

"The substitute, therefore, makes provision to meet the situation where a holding company can show a real economic need on the part of additional integrated systems for permitting the holding company to *keep these additional systems under localized management with a principal integrated system. Under such circumstances the Commission is directed to permit the holding company to retain control of such additional systems, even though not physically integrated with the principal system, provided all such integrated systems are located in the same State or States, or in adjoining States or a contiguous foreign country.*¹⁴" (H.R. Rep. No. 1903, 74th Cong., 1st Sess., pp. 70-71.)

¹⁴ Throughout this brief emphasis in italics has been added.

It is clear from the Conference Report that the compromise provision was not intended to permit a holding company to control public-utility companies operating in widely scattered areas. It was partly on this ground that certain Representatives who favored the House bill and opposed the Senate proposal also opposed the compromise, specifically asserting that the compromise would in practical effect retain the restriction on a holding company to a single integrated system.¹⁵

A further clear statement of Congressional intent is contained in a statement by Senator Wheeler, Chairman of the Senate Committee which considered the bill, and a member of the Conference Committee. This statement was made

¹⁵ See remarks by Representative Huddleston, a member of the House Committee on Interstate and Foreign Commerce and a Manager on the Part of the House at the Committee of Conference, 79 Cong. Rec. 14167, August 24, 1935, quoted in Pet. App. 265-66; and cf. remarks of Representative Cooper of Ohio, also a member of the House Committee on Interstate and Foreign Commerce, *id.* at 14166:

"The second condition for more than one utility system exists 'if all of such additional systems are located in one State or in adjoining States.'

"That provision is of little importance since, as stated, most of the utility holding companies have acquired their properties in different territories in order to diversify the risk"

"I submit to you that the exception granted on the basis of these three conditions does not materially modify the limitation to one integrated public-utility system, nor will it in any way prevent the dismemberment of practically all utility holding companies."

On the other hand, Representative O'Connor, who voted for the substitute Section 11(b)(1), regarded it as a relaxation of the Senate version in that it permitted

"holding companies which are really integrated units and are natural units, to operate in a real concentrated territory without spreading their talons all over the country with an Insull in Chicago picking up a little power plant in Florida or a Hopson from 61 Broadway, New York City, operating a little plant in Oklahoma at the expense of the consumers and the investors." (Id. 14168)

in the Senate immediately after the passage of the bill and two days before it was signed by the President. Senator Wheeler said:

"Section 11 in the Senate bill, as you will recall, required that a holding company limit its operations to one integrated operating system and to businesses reasonably incidental thereto. The House bill also purported to limit the operations of a holding company to one integrated system, but permitted an exception which allowed the Commission to permit a holding company to control as many systems as it deemed consistent with the public interest. The House bill accordingly thrusts the entire burden of breaking up the giant holding companies upon the Securities Commission without any effective or constitutional standard to guide them in their task and with no concrete congressional sanction to fall back upon to resist the pressures that would inevitably be brought against the Commission to prevent their taking any effective action. *Since both bills accepted the proposition that a holding company should normally be limited to one integrated system, my colleagues and I conceived it to be our task to find what concrete exceptions, if any, could be made to this rule that would satisfy the demand of the House for some greater flexibility. After considerable discussion the Senate conferees concluded that the furthest concession they could make would be to permit the Commission to allow a holding company to control more than one integrated system if the additional systems were in the same region as the principal system and were so small that they were incapable of independent economical operation and if the combination of these small systems under one holding company would not create a corporation so large as to impair the advantages of localized management and the effectiveness of regulation. I consider this a very generous concession upon the part of the Senate. If properly administered, however, this concession should not defeat the purpose of the President to break up the giant holding companies with their undue concentration of economic power and with their absentee management by remote control . . .*

"The Senate had to yield on the provision that all holding companies should cease to be holding companies after 1940 unless affirmatively found to be necessary to

the operations of an integrated system under the applicable State law. The provisions retained in the bill, however, which require as a general rule the limitation of the holding company to one integrated system and which require that the corporate structure of the holding company be not unnecessarily complicated, should serve to break up all of the unnecessarily large and complicated holding-company empires" (79 Cong. Rec. 14479, Aug. 24, 1935).

Finally, the legislative intent is set forth in Section 1(c) of the Act itself:

" . . . it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section . . ."

These problems and evils include the adverse effect on the national public interest and the interest of investors and consumers which, the Congress has found, results (or may result)

" . . . when the growth and extension of holding companies bears no relation to economy of management and operation or *the integration and coordination of related operating properties*;" (Sec. 1(b) (4))

Thus it is abundantly clear that among the several tests of Section 11(b) (1) which additional systems must meet to qualify for retention with the principal system is the requirement that they be located close to the principal system. The Conference Report describes the statute as requiring that "all such integrated systems"—the principal and the additional systems—"[be] located in the same State or States, or in adjoining States." Senator Wheeler described their permissible area of operations of the principal and additional systems as the "same region."

Applying this test to the proposed Virginia-Gulf-El Paso combination, with Virginia and Gulf 850 miles apart at their closest points and 1300 at their furthest and with Virginia and El Paso from 1600 to 1800 miles apart (Ex-

hibit 3 to this Brief), how could any conclusion be reached other than that the statute required the severance of Gulf and El Paso from Virginia? How could their retention with Virginia produce a combination located in the "same State or States or in adjoining States", or in the "same region"?

This limitation of a principal and additional systems to a single area the Commission found to be embodied in the Act in subsection B of the proviso to Section 11(b)(1). That section, after imposing the requirement that a holding company limit its operations to "a single integrated public-utility system", adds the following exception:

"Provided, however, That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

"(A) . . . ;

"(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

"(C) . . ."

The Commission ruled that this provision was designed to carry out the Congressional purpose of limiting the permissible area of operation of a utility combination to the "same region", and that additional systems could, therefore, be retained only if they were situated in the same State or States as the principal system or in States adjoining the principal system.

Petitioners, however, in their desire to retain control over the three chief income-producing utilities in the Engineers system—Virginia, Gulf and El Paso—in the face of this clear indication of Congressional policy, have read into Section 11(b)(1) a meaning which would permit the existence of the Virginia-Gulf-El Paso combination, but which is at variance with the intent of the section. (This will be designated as "two-area interpretation" since it permits utility combinations in two distant areas. The Commission's interpretation will be referred to as the "single-area

interpretation.”) Under petitioners’ interpretation additional public-utility systems may be retained by a holding company under Clause (B) if all such systems are located in any one State of the United States *no matter how remote from the principal system*, or in States adjoining each other (or in a contiguous foreign country) but *likewise remote from the principal system*. Under this two-area interpretation petitioners assert that the retention of the electric utility systems of the Virginia-Gulf-El Paso combination would not be barred by Clause (B).

The background of the statute—the Congressional insistence on proximity between the component utilities in a holding-company system, and on localized management—leaves no room for doubt that the Congress did not intend a holding company to be allowed to control properties as widely scattered as the combination proposed by petitioners. The legislative history supplies ample support for the Commission’s finding that the Virginia-Gulf-El Paso combination was prohibited by the Act.

This conclusion is reinforced by an examination of the practical consequences of the interpretation advanced by petitioners.

It has already been pointed out that Section 11 looked primarily to confining a holding company to one public-utility system, and that it was only as an exception to this policy that an additional system or systems might be retained.¹⁶

¹⁶ The exception, of course, must be strictly construed.

“It is insisted that the exception in the act should receive such a broad construction as would destroy the plain purpose which caused the act to be adopted. But . . . exceptions from a general policy which the law embodies should be strictly construed; that is, should be so interpreted as not to destroy the remedial processes intended to be accomplished by the enactment.” *Spokane & Inland Empire R.R. Co. v. United States*, 241 U.S. 344, 350 (1916); *Securities and Exchange Commission v. Sunbeam Gold Mines Co., et al.*, 95 F. (2d) 699, 701 (C.C.A. 9, 1938).

Thus, under petitioners' version of Clause (B), additional systems located in adjoining states may be retained, irrespective of their proximity to the principal system. Clearly, this result was not intended by the Act. And as applied to the facts of this case, the interpretation produces a result irrational on its face. For with the principal system of Virginia (located in the States of Virginia and North Carolina) and with Gulf and El Paso (in Louisiana, Texas and New Mexico) as additional systems claimed by petitioners, Engineers could not under Clause (B) retain or acquire any other additional system in Virginia or the states adjoining it—despite the fact that utility systems in these states would be considerably closer to the principal system and would thus render the holding-company system more compact geographically. In fact, the gas system of Virginia would not be eligible for retention with the Virginia-Gulf-El Paso combination as additional systems under petitioners' interpretation, for it is not in a state adjoining Louisiana, Texas or New Mexico. Petitioners, however, desire to retain the Virginia gas system as well and in dealing with this property they abandon their own position on Clause (B) and argue that it may be retained even though it does not adjoin the other additional systems (Pet. B. p. 86).¹⁷ It is clear that on no interpretation of the statute which has been suggested can petitioners retain both the Virginia gas system and the Gulf and El Paso electric systems as additional systems to the Virginia electric system. If they press for their interpretation of Clause (B) in order to keep the Virginia electric-Gulf-El Paso combination, they cannot consistently ask to keep Virginia gas. If they desire to keep Virginia gas as an additional system with Virginia electric, Clause (B) requires the divestment of Gulf and El Paso. This inconsistency into which petitioners have been led by their construction of Clause (B) is merely another proof of the absurdity of that construction.

¹⁷ The retainability of the Virginia gas system under the Commission's construction of the statute is discussed *infra*, pp. 22 ff.

Further corroboration for the Commission's one-area interpretation is found in Clauses (A) and (C) of Section 11(b)(1). Section 11(b)(1) provides that to be retainable additional systems must meet the conditions of both these clauses as well as Clause (B). Therefore these clauses if read together illumine the meaning of Clause (B). In this context Clause (B) is a mechanical test designed to set the outside limits of a system, which would then be further limited by weighing facts under the (A) and (C) clauses. Thus, the (B) clause is an indication that properties excluded by it were regarded by the Congress as being of a type which clearly could not meet the (A) and (C) clauses and therefore of a type in which the taking of evidence would involve useless effort. As indicated in the Conference Report, *supra*, the conference substitute was intended to contain "an effective standard for the guidance of both the Securities and Exchange Commission and those holding companies which wish voluntarily to comply with Congressional policy." Without the indication in Clause (B) as to the outside geographical limits of permissible systems it is questionable whether this objective could have been fully realized.

Clause (A) requires, as a condition for retaining an additional system, that the latter "cannot be operated as an independent system without the loss of substantial economies" possible through retention. Since it is obvious that additional systems in an area considerably distant from the principal system can readily be operated independently with little or no loss of economies, petitioners' interpretation of Clause (B) would run counter to the purposes of the clause and would result in the taking of much useless testimony. Clause (C), which refers to the combination of systems under the control of the holding company—the principal as well as the additional systems—requires the combination to be "not so large (considering the state of the art and the area or region affected)" as to have certain undesirable effects. It will be noted that the words "area" and "region"

are used in the singular. Under this clause it is clear that a permissible combination of principal and additional systems must be located in one area or region, not in two or more.

Further, among the purposes of Clause (C) is to insure that the additional systems shall be kept "under localized management with a principal integrated system".¹⁸ It is clear that the scattered properties permitted under petitioners' two-area interpretation cannot be kept "under localized management with" the principal system.

Further, as applied to the facts already in the record, the (A) and (C) clauses corroborate the correctness of the Commission's interpretation of Clause (B). The Commission found that El Paso with some \$12,000,000 of electric properties had not met the (A) standards as additional to the Gulf electric system, and that finding is not challenged here. Since El Paso could not establish that substantial economies would be lost by operation independent of Gulf, *a fortiori* it could not establish such loss of economies from operation independent of the more distant electric system of Virginia. And Gulf itself, with some \$55,000,000 of electric properties, is of such a size that Engineers claimed to have difficulty in deciding whether it or Virginia should be its principal system. Against this background the Commission could hardly have found that the Gulf and El Paso systems, which petitioners themselves describe as "relatively important electric operating systems" (Pet. B. 48), could not be operated as independent systems without the loss of substantial economies. The distance between Virginia and Gulf at their nearest points is 850 miles, between Virginia and El Paso, 1600 miles. On this showing it would have been impossible to find that Gulf and El Paso could be kept "under localized management with" the Virginia electric property.

In the light of the language of the statute and its purposes as revealed by the legislative history, by practical application, and by the standards complementing Clause (B), it seems clear that the statute contemplated the one-

¹⁸ Conference Report, *supra*, p. 13.

area interpretation of Clause (B) adopted by the Commission. Under this construction Gulf and El Paso, not being located in the same State as the Virginia electric system or in States adjoining it, are not retainable as systems additional to it. The Commission therefore properly ordered their divestment.¹⁹

B. THE VIRGINIA GAS PROPERTY IS NOT RETAINABLE AS AN
ADDITIONAL SYSTEM WITH THE VIRGINIA ELECTRIC
SYSTEM.

1. *The Commission properly applied Clause (A) of
Section 11(b)(1).*

The Commission found that Virginia's gas property constituted an integrated public utility system as defined by the Act.²⁰ Its retainability with Virginia's electric system therefore depends on whether it qualifies under Clauses (A), (B) and (C) of Section 11(b)(1) for retention as an additional system. The Commission found that such retention would not be barred under Clause (C) or under its interpretation of Clause (B),²¹ but that Clause (A) was not

¹⁹ The petitioners also object to the failure of the Commission to permit the introduction of evidence on the (A) and (C) standards (Pet. App. 65-66). All three standards, (A), (B) and (C), must be complied with to permit retention. Thus, if the Commission's construction of Clause (B) was correct, the properties were not retainable and (A) and (C) evidence was properly rejected as irrelevant. In addition, it seems clear from the discussion *supra* that the (A) and (C) standards could not have been met.

²⁰ Section 2(a)(29)(B).

²¹ It has already been pointed out that under petitioners' interpretation of Clause (B), the Virginia gas system could not be retained with the Gulf and El Paso electric properties. Petitioners' brief appears to ignore this inconsistency, for it denies the Commission's interpretation of Clause (B) when it stands in the way of petitioners' retaining the Gulf and El Paso electric systems, but inconsistently urges the retention of

met, and that the divestment of the gas system was therefore necessary. Section 11(b)(1) requires a holding company to limit its operations to "a single integrated public-utility company" and adds the following exception:

"Provided, however, That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system; . . ."

It will be noted that the statutory terms permit the retention of an additional system only if the Commission finds that it can^{not} be independently operated without the loss of substantial economies obtainable through its retention. To ascertain the meaning of the term "substantial economies" in Clause (A), we turn again to the legislative history of Section 11(b)(1), of which extensive portions were cited above to show the meaning of Clause (B). After referring to the limitation of holding companies to a single utility system both in the House and Senate bills, the Conference Report enumerated the exceptional circumstances under which, according to the substitute bill, additional systems might be kept. The Conference Report said:

"The substitute, therefore, makes provision to meet the situation where a holding company can show a real economic need on the part of additional integrated systems for permitting the holding company to keep these additional systems under localized man-

(Footnote 21 continued)

the Virginia gas system although that system does not adjoin Gulf or El Paso. The Commission's finding that the (B) standard did not bar the retention of the Virginia gas system was of course based on its interpretation of Clause (B), not on petitioners'.

agement with a principal integrated system." (H.R. Rep. 1903, 74th Cong., 1st Sess., p. 71)

Senator Wheeler also referred to the "proposition that a holding company should normally be limited to one integrated system," but that, as "concrete exceptions."

"the Senate conferees concluded that the furthest concession they could make would be to permit the Commission to allow a holding company to control more than one integrated system if [among the other tests] *the additional systems . . . were so small that they were incapable of independent economical operation.*" (79 Cong. Rec. 14479, August 24, 1935)

The legislative background would thus require the Virginia gas system to be "so small [as to be] incapable of independent economical operation" and to show "a real economic need" in order to qualify for retention by Engineers under the (A) test. After a review of the evidence on the Virginia gas system as a proposed additional system with Virginia electric, the Commission concluded that the increased expenses which petitioners estimated would occur on divestment were on their face insubstantial or were exaggerated and unreliable. The Commission concluded further that the calculations had overlooked substantial savings which would be brought about by divestment. Other advantages of independent operation of electric and gas were also ignored in petitioners' calculations. On the basis of the record the Commission was unable to make the necessary affirmative finding that Virginia gas could not "be operated as an independent system without the loss of substantial economies which can be secured by . . . retention." It, therefore, held that the (A) standard had not been met by the Virginia gas-Virginia electric combination, and that Engineers was, therefore, required to divest itself of Virginia gas.

In *The North American Company v. Securities and Exchange Commission*, *supra*, where the Court was called upon

to review a similar refusal by the Commission to make the statutory findings under Clause (A), the Court said:

"After considering these arguments and the evidence presented in their support, the Commission refused to find that the additional systems could not be operated independently without the loss of substantial economies. Whether economy is achieved by centralized control is always a doubtful question and one peculiarly fitted for decision by an administrative agency staffed by experts. On such an issue a court cannot review or reweigh the evidence. See *Morgan Stanley & Co. v. Securities Exchange Com'n.*, 126 F. 2d 325 (C.C.A. 2); Section 24 (a) of the Act, 15 U.S.C.A. §79x (a)."

2. *The Commission's Conclusion Is Supported by the Record.*

While the Commission is recognized as having a specialized technical competence in passing on the questions presented by Clause (A),²² a review of the contentions before the Commission will serve to demonstrate the correctness of its action.

Petitioners' evidence on lost economies was almost entirely based on their premise that the severance of the gas and electric system would put a stop to savings they claim now arise through the fact that the two are jointly operated. Utility representatives contended before Congress that savings could be expected to result from joint operations of utility systems.²³ Since the Congress nevertheless adopted a policy normally limiting holding companies to one system

²² See extract from *The North American Company v. Securities and Exchange Commission*, *supra*.

²³ Hearings before Committee on Interstate and Foreign Commerce on H.R. 5423, 74th Congress, 1st Session (1935), Part 2, pp. 1249, 1402-3, 1530-31, Part 3, pp. 2257-77.

Hearings before Committee on Interstate Commerce on S. 1725, 74th Congress, 1st Session (1935), p. 65. The Supreme Court has cited testimony before Congressional committees in ruling on questions of statutory interpretation. See footnotes 7 and 8 in *Federal Security Administrator v. Quaker Oats Co.*, and footnote 1 in *Viereck v. United States*, — U.S. —, both decided March 1, 1943.

and permitting additional systems only in exceptional circumstances, it is a reasonable inference that the Congress thought that such expenses as customarily arise on severance of joint operations are not truly lost economies.²⁴ Further, countervailing advantages can usually be obtained by divestment. Thus, increased expenses may well be productive of increased income which far outweighs its cost. So, also, the advantages secured from separate staffs with undivided loyalty to the conduct of businesses so inherently competitive as are gas and electricity must be given their due significance. The Commission found, however, that petitioners had ignored such advantages in their presentation, and, moreover, that a large number of the increased expenses which petitioners claimed would result from divestment were exaggerated.

We turn to petitioners' estimate of increased expenses attributed to the gas system²⁵ on divestment. An examina-

²⁴ The fact that Congress did not go so far as to adopt an outright prohibition on a combination of gas and electric systems under one holding company does not mean, as petitioners claim, that Congress intended that such joint ownership was always to be permitted under the Act. It signifies no more than that Congress believed that under some circumstances the advantages of retention outweighed those of divestment, and that it, therefore, preferred the Commission to handle the problem on a case-to-case basis. But it should be remembered that the overall policy of the statute was to confine holding companies to a single system.

²⁵ As applied to Virginia's electric system, the increased expenses of operation attributed by petitioners to the separate operation total \$56,000. This is equivalent to but 3/5 of 1 per cent of the electric system's operating expense, including taxes and depreciation for 1940 (Pet. App. 839). Even if it is assumed that "increased expenses" are synonymous with "lost economies", and, even if it is assumed further that petitioners' estimate is correct, no "loss of substantial economies" to the electric system on divestment can be made on this showing. As the Court said in *The North American* case, *supra*, in interpreting this phrase in Clause (A),

"With the Commission's ruling that 'substantial economies' means important economies and not merely something more than nominal, we are in accord."

tion of their contentions will show that they have overlooked no possible avenue of increased expense and have included none of the resulting savings, a procedure obviously not appropriate for discovering whether economies will in fact be lost.

First, petitioners estimated that there would be \$18,592²⁶ of increased expenses on account of customers' accounting and collection. Upon examination of petitioners' own witness, this figure was shown to be disproportionately high. Petitioners' witness admitted that some of the employees alleged to be necessary could in fact be dispensed with.²⁷ Estimates for the item of billing and accounting work for gas customers alone turned out to be more than the present cost for billing the same number of customers for both gas and electricity,²⁸ to the confusion of petitioners'

²⁶ Pet. App. 332. It is interesting to note that petitioners' estimates of increased expenses are submitted as accurate to the last dollar. Such care in calculation, it would seem, should likewise have resulted in discovering the savings which occur on divestment and reducing them to equally precise dollar amounts. Unfortunately, this does not appear to be the case.

²⁷ Petitioners asserted that both a credit manager and a supervisor of customers' accounting and collection would be necessary for the separate gas system. Upon cross-examination, however, their witness testified that the two positions might be consolidated (Resp. App. 15-16). Petitioners assert three cashiers would be necessary (R. p. 3892). Their witness stated that two cashiers might be sufficient and could even do other clerical work (Resp. App. 13-14).

²⁸ Billing and accounting, it was alleged, would cost the independent gas system a total of \$19,800, or an increased expense of \$10,100. Yet the entire cost to the present gas system alone for such work for its 29,000 customers is \$9,700 (Resp. App. 14-15). The present cost to the electric system for such work for the same number of customers is also \$9,700. The total present cost for the 29,000 combination gas-electric customers (for all the customers of Virginia's gas system also obtain electricity from Virginia's electric system) is \$19,400 (Ibid.). Yet petitioners assert that it would cost more than this to perform billing and accounting work for the gas system alone. In other words, this implies that the loss of efficiency in such work as a result of the gas system's separate operation would exceed 100 per cent—what now costs \$9,700 would, it is alleged, cost \$19,800.

witness when called on to explain the discrepancy.²⁹ This exaggeration was confirmed by an examination of the method employed by petitioners in allocating salaries of such work now performed jointly for the gas and electric systems.³⁰

Petitioners also alleged increased expenses for general and administrative expenses in the amount of \$45,130. Of this sum, \$16,360 is asserted by petitioners to be necessary to pay an outside organization for performing "managerial" services for the independent gas system. Since almost no independent gas company regards it as necessary to contract for such servicing³¹ and since the presumptive presi-

²⁹ Petitioners' witness, when asked to reconcile these figures (Resp. App. 25-29), said (Resp. App. 29) :

"I would not think, normally, that it would cost more, but under the setup here, it appears to cost more."

³⁰ The application of this method showed that in contrast to the claimed increase of \$10,100 to the independent system, the increased expenses for billing and accounting would total no more than \$3,200. Petitioners' method of allocation assumes in effect that the work of billing and accounting a single joint gas-electric customer for both services in one operation requires 25 per cent less time—and therefore costs 25 per cent less—than billing and accounting work for the single customer for the two services separately. Under separate gas operations, all the customers will be single-service gas customers. Therefore, the sum of \$9,700, which is now allocated to billing and accounting joint gas-electric customers for their gas consumption, is 25 per cent less than the cost should be, under petitioners' allocation, for billing and accounting the single customers of the separately conducted gas system. This cost would thus be \$12,933 (\$12,933 less 25 per cent of \$12,933 (\$3233) = \$9,700), which is not \$10,100 more than the present cost of \$9,700 (as petitioners claim the increase would be) but only about \$3,200 more.

³¹ Brown's *Directory of American Gas Companies*, a standard descriptive manual of the gas industry, shows this clearly and petitioners did not submit any evidence to show that any of the numerous independent gas systems in the country maintained any managerial servicing arrangements.

For a description of the history of servicing arrangements in holding company systems, see the Supplement to this Brief at pp. 41-45.

dent of the independent gas system displayed an amazing lack of knowledge of specific need for obtaining such services,³² the Commission could properly give little credence to this claim. Particularly was this proper since it seems highly likely that the present operating personnel is competent to perform managerial and supervisory services.³³ Petitioners also estimated that the gas system would pay \$23,000 a year for salaries of general officers and executives (Pet. App. 861)—*twice* the amount presently allocated to the gas system, or an increased expense of \$11,500. Yet it appears that the gas system presently is operated by one man (Resp. App. 34), and that the general executives of the company devote only about 5 per cent of their time to it (Resp. App. 30).

In the light of the character of the work performed by the general executives,³⁴ the doubling of the gas property's executive compensation for this purpose appeared to the Commission to be excessive. On the other hand, if full-time executives, working with an eye single to the advancement of the independent gas system, can be expected to be of greater service to it than Virginia's executive staff, the advantages to the gas system should be offset against the necessary increased expenditure. Petitioners, however, have failed to consider this aspect of the matter.³⁵

³² See testimony of R. J. Throckmorton, vice president of Virginia in charge of its gas operations (Resp. App. 29-30).

³³ The fact that such managerial and supervisory services have been rendered to the Virginia gas system in the past is due at least in part to the holding company's historical policy of reserving such functions to itself. Although the operating personnel have thus never been given the opportunity to exercise their uncontrolled judgment in such fields (Resp. App. 4-9), the holding company continuously recruits its supervisory staff from among them (*Ibid.*).

³⁴ Petitioners' witness described this work as "checking the operations and seeing how the property is going; discussing possible expansion. It does not take very long" (Resp. App. 30).

³⁵ As to the remainder of petitioners' estimates of increases in general and administrative expenses, a mere enumeration of them illustrates their exaggerated nature (Pet. App. 861). It is alleged that expenses of general officers would be over 400

Petitioners further estimated that sales promotion expenses would increase by \$7,800 a year, of which \$5,300 is attributed to setting up a sales staff and \$3,500 to advertising expenses (Pet. App. 859). The increased expenses for additional sales employees have no foundation in the record.³⁶ The alleged \$2,500 increase in advertising expenses was completely contradicted by petitioners' own witness (Resp. App. 31-33).³⁷ Even if it were correct, however, the nature of such advertising—building up good-will for the “new” enterprise (R. p. 3904, Resp. App. 33-34)—might be expected to result in additional business and might be the

(Footnote 35 continued)

per cent of what they presently are; other general office salaries would be over 160 per cent of what they presently are; legal services would be over 160 per cent of what they presently are.

³⁶ The sales staff which petitioners would supply to their theoretical separate gas systems would include, among others, three gas sales engineers and a sales manager (Pet. App. 860). In contrast, however, the system at present has a comparable staff of two sales engineers working exclusively on sales of gas (Resp. App. 31), and no satisfactory explanation appears for the need for three where two now suffice. Nor have petitioners shown why the gas sales manager and one of the sales engineers could not be combined in one person. The functions of the gas sales manager and electric sales manager are now performed by one person. Of his salary, \$861.25 was charged to the gas department for 1940 (Pet. App. 851) as against the \$5,000 claimed by petitioners for the independent gas company's assertedly necessary full-time sales manager (Pet. App. 860).

³⁷ This witness testified on cross-examination that the entire annual advertising budget for both the gas system and the gas appliance business would be \$3,600 (Resp. App. 31). Since the gas appliance business had advertising expenses of about \$2,500 in 1940, it is obvious that advertising expenses of the gas system alone, by this testimony, would be approximately \$1,100 or an amount which is about equal to the present advertising expense of the gas system. The alleged increase of \$2,500 fails to materialize (Resp. App. 32-33).

kind of expense which results in increased income rather than loss of economies.³⁸

The foregoing review of the facts illustrates why the Commission found the petitioners' estimates to be excessive, and why it concluded in its opinion that "the record, if given its most liberal interpretation, would not sustain a finding of more than one-half the claimed increased expenses" (Pet. App. 105). Even assuming this maximum showing, the claimed increased operating expenses would result in only a 4.7 per cent increase in gas operating expenses for 1940 (Pet. App. 839).³⁹

Petitioners' figures, furthermore, take no account of the elimination of the now continuous expenses of allocating salaries and cost of facilities among the several enterprises conducted by Virginia, part of which is now borne by the gas system but would be obviated by its independent status.⁴⁰ This is an outright saving possible only through

³⁸ On the other hand, if it is not intended as a regular expense but to be incurred only in the initial stage of the independent existence of the gas system, it is a non-recurring expense of little significance.

³⁹ Obviously the impact of increased operating expense to the independent gas system is most properly compared with the item of which it will form a part—the operating expenses of the present gas system—for it is gross income after operating expenses which reflects the allowable return in a regulated industry. For that reason a comparison of increased operating expenses with gross or net income (respectively, 13.3 per cent and 29.8 per cent) has no bearing on the actual result. As the subsequent discussion shows, even these percentage comparisons are further reduced by other savings and a consideration of countervailing advantages resulting from divestment.

⁴⁰ Petitioners' witness testified that some forty-five employees in the general accounting office are "bound to" (Resp. App. 18) spend some time on allocation of expenses; since he would not say what amount of time such employees would spend in this work, it is a fair conclusion that the equivalent of several employees' salary is expended on allocation work arising entirely from the fact that the systems are combined,

divestment, which petitioners did not even mention as a credit against their estimates.

Moreover, the Commission held that in determining whether loss of economies would result, it must consider not only increased expenses on divestment but countervailing benefits of independent operation. The Commission, therefore, took into account the fact that economic advantages would result from placing the inherently competitive gas and electric businesses on a truly competitive plane.⁴¹

(Footnote 40 continued)

which would be eliminated on their severance. In fact, petitioners' witness said that the mechanics of the method of allocating expenses might necessitate an enlargement of their staff (Resp. App. 17), but petitioners have not credited this saving to the independent gas system. Nor did petitioners see fit to credit the independent gas system with savings arising from the fact that allocation studies no longer would be needed, although presently it is planned to make such studies from time to time (Resp. App. 17-18).

⁴¹ Thus, in testifying with respect to the Gulf gas and electric combination, the treasurer of Gulf, when asked why the need for separate service buildings for independent gas and electric systems could not be obviated by the gas system's renting a portion of the service building now used jointly, replied (Resp. App. 34-35) :

A. If I had anything to do with it I don't believe you would keep it there.

Q. That is because you wouldn't want your competitor in the same building.

A. That is because if two interests got together, why, I don't believe they get along very well. We have a common interest now and it would be separate interests under this proposed gas company being a separate company. There wouldn't be anything in common.

Q. Would you say that if the gas department were independent that they would have conflicting interests with the electric operations?

A. I think the gas, another gas company would try to do its best job, and they may want to do things differently than they are being done now.

Q. You wouldn't say that the interests of a gas utility and an electric utility though would run cross current, would you?

A. I believe they would if they were separate.

Among such advantages there must be reckoned economies which could be realized by a staff singly devoted to operating a gas system, which may well be lost when the gas system is operated by a group of executives who devote almost all their time to a vastly larger and more remunerative electric system. That these advantages may be of substantial importance is clear from the record. The present joint operation has resulted in abuses in allocating expenses between the gas and electric properties,⁴² which have affected the rate structures of both properties.⁴³ Severance between gas and electric operations will, of course, effectively eliminate these abuses. Economies of this type cannot be ignored.

A consideration of all the facts shows that the Commission's refusal to find that the standards of Clause (A) had been met was amply supported by the record. The Commission properly required that the gas system be divested.

⁴² Not only has there been a failure to allocate or separate the expenses of many specific items such as the failure to segregate retirement reserve among departments (Resp. App. 1158, 38) and the failure to charge the gas system proper rentals for building space used by it (Cf. Pet. App. 823 with Resp. App. 18), but there has been an over-all erroneous allocation. Thus, prior to 1933, expenses were allocated between Virginia's departments in the ratio which the gross revenues from each bore to the total. After that year they were allocated on a net revenue basis, the prior year's revenues furnishing the annual yardstick for the current year's allocation (Resp. App. 19-24). The effect of this change was to increase the expenses allocable to the electric department and to decrease the expenses allocable to the gas department (Resp. App. 35-36). Neither method of allocation bore any relationship to the actual expenses involved (Resp. App. 19-24, 38-43). With the commencement of this proceeding still other allocations have been suggested by the petitioners (Resp. App. 16).

⁴³ Resp. App. 43-44.

C. THE COMMISSION PROPERLY ORDERED THE DIVESTMENT OF VIRGINIA'S TRANSPORTATION PROPERTIES AND EL PASO'S TRANSPORTATION AND TOLL BRIDGE PROPERTIES.

1. *The Properties Do Not Bear the Relationship Which the Statute Requires to the Operations of the Respective Electric Utility Systems.*

The Commission ordered Virginia to dispose of street railway and bus facilities which it operated in Richmond, Petersburg, Norfolk and Portsmouth, Virginia, and an interurban bus service between Richmond and Petersburg. It also ordered El Paso (Del.), itself a registered holding company, to dispose of the street railway and bus system in and about the cities of El Paso, Texas, and Juarez, Mexico, including two toll bridges connecting the cities.⁴⁴ These businesses were operated by two subsidiaries, El Paso and El Paso and Juarez Traction Company. These divestments were ordered because the Commission held these properties not to be retainable with the electric systems of Virginia and El Paso respectively under the provisions of Section 11(b) (1) relating to the retention of other businesses. The section directs the Commission

"To require . . . that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system . . ."

It further provides:

"The Commission may permit as reasonably incidental, or economically necessary or appropriate to the opera-

⁴⁴ Reference to the transportation properties of El Paso will be regarded as including toll bridges.

tions of one or more integrated public-utility systems the retention of an interest in any business (other than the business of a public-utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems."

The transportation properties of Virginia and El Paso were ordered divested under these standards because, on the evidence, the Commission could not find that such businesses were reasonably incidental or economically necessary or appropriate to the operations of the electric utility systems of Virginia and El Paso, respectively. Petitioners argue that the Commission erred in holding that the statute requires divestment of properties not related "to the operations" of a retainable electric utility system. Petitioners urge that no relationship to the operations of the retainable system is necessary. If the Commission properly construed the statute in holding that such a relationship is necessary, it is apparently undisputed that the Virginia and El Paso transportation businesses may not be retained. Indeed, petitioners could not, if they would, maintain such a contention since it is clear on the evidence that no such relationship exists between the properties in question and the operations of the retainable electric utility systems as warrants retention together with the electric properties.⁴⁵ For example, Virginia's vice president in charge of the transportation business admitted that

⁴⁵ The Commission held that an ice plant at Williamsburg operated by Virginia bore the requisite relationship to the operations of Virginia's electric system for it heated the electric plant in the wintertime and cooled it in the summertime (Pet. App. 96-97). The electric appliance businesses of both Virginia and El Paso were also found reasonably incidental to the operations of their respective electric systems for they served to educate the public in the uses of electricity and to increase electric consumption (Pet. App. 97-99, 149). The Commission, therefore, held these properties retainable with the electric properties to which they were related.

"the problems are so different that it is better to have a man devote his time to the study of the transportation problems and let someone else devote their time to the study of the electric problems, within the limits of the actual operations (Resp. App. 37).

A virtually identical admission was made by the president of El Paso.⁴⁶

Petitioners' contention that no relation to the operations of a retainable utility property need be shown under the other business clauses is wholly at variance with the

⁴⁶ Q. From an operating standpoint, there is not any substantial relationship between transporting persons in busses and the transmission and distribution of electric energy, is there?

A. *Not in the way that you mean, I am sure, but in my opinion I think there is a substantial advantage in the fact that we operate both, organization-wise.*

Q. *Do you mean by reason of the bigness of the company in having both operations?*

A. *I mean, by reason of the security of the employee, the security we are able to offer to the employee.*

Q. If the company were operating an oil business, it would be able to offer quite a bit of assurance of employment to all employees of a substantial nature, because of the security of the electric business, is not that true?

A. Do you mean if the company were operating an oil business and the electric and transportation business?

Q. *If the company were operating an oil business and an electric business, you would have the same relationship that you spoke of that existed between the bus business and the electric business?*

A. *To some extent, I think you might well have it, yes, sir. . . .*

Q. Is the matter of public relations the only vital common factor between the two businesses?

A. Well, I do not know as I would call it a common vital factor.

Q. It would have to be considered as a vital factor?

A. I would consider it an important factor and I would consider the advantages to the organization as an extremely important factor.

Q. Is there any other important factor?

A. *No, except to make some money out of each one of them (Resp. App. 52).*

clear language of Section 11(b)(1) and with the purposes of the statute. The same contentions as are made here were presented to the Second Circuit and rejected in the *North American* case, *supra*, where the Court said:

"The Commission interpreted these 'other business' clauses to permit retention only when it affirmatively appears 'that the public interest will be furthered by retention of a non-utility interest by reason of its relation 'to economy of management and operation' of a public utility system or systems or 'the integration and coordination of related operating properties.'" This conclusion is consonant with the policy of the Act expressed in Section 1(b)(4), 15 U.S.C.A. §79a(b)(4) which declares that 'the national public interest' is or may be adversely affected 'when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties.' We agree with the Commission's interpretation. It is apparently not disputed that the three other businesses are *unrelated to the operations* of the St. Louis system. Consequently no error appears in ordering their divestment."

This clearly sustains the Commission's order for divestment of the Virginia and El Paso transportation properties.

However, petitioners seek to support their construction by reference to earlier drafts of the bill subsequently rejected. By this device petitioners arrive at constructions which ignore both the language and purposes of the statute.

In dealing with the petitioners' objections we shall consider the policy of the other business clauses as set forth in the statute and in the legislative history.

The policy adopted by Congress was based on an industry-wide study which had revealed that generally speaking investments in speculative and unrelated businesses lead to losses and result in unnecessarily complex management problems. Congress concluded that only by confining the scope of operations of a holding company system to a single integrated system with narrowly defined exceptions, could

investors be protected from possible misapprehension as to the risks inherent in investment in securities of holding companies; and could the consumer and investor interest in the obtaining of new capital upon the most economical terms be advanced, and undue concentration of economic power be sufficiently curbed.⁴⁷ To have left these policy determinations open to Commission findings in each proceeding would have required the repetition in each instance of the kind of legislative investigations made by the Federal Trade Commission and the Congressional committees and would have also laid the Act open to possible attack on the basis of undue delegation of legislative power. These difficulties, in fact inherent in an earlier House version of Section 11(b)(1), were the basis of specific objection to that draft and for that very reason there was substituted the more specific language in the final bill.

This House bill read as follows:

"The Commission shall not . . . require any company to divest itself of any interest in or control over (1) persons or property other than a public-utility company or the utility assets of a public-utility company *unless the Commission finds that such interest or control may not be retained consistently with the public interest* . . ." S. 2796, Section 11(b), Union Calendar No. 451, accompanied by H. R. Rep. No. 1318, 74th Cong., 1st Sess. (1935) at p. 17.

In commenting on this bill, Senator Wheeler said:

"Section 11 of the House bill not only does not require utility holding companies to get out of the myriad of speculative non-utility adventures in which they have been promiscuously active in the past, but it specifically hampers the Commission in dealing with these non-utility interests . . . Instead of Congress adopting a definite policy with regard to these speculative, non-utility activities, the House section shifts the entire

⁴⁷ These points are more fully developed in the Supplement to this Brief.

burden to an administrative Commission, and then makes it practically impossible for the Commission to do anything about cleaning up the situation" (79 Cong. Rec. 10847, July 9, 1935).

The conference report and the final bill removed these difficulties and adopted a standard of relation to the operations of retainable integrated utility properties.

In its findings Congress stated that the national public interest is or may be adversely affected "when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of *related operating properties*." (Section 1(b)(4)). Congress further directed that "all the provisions of this title shall be interpreted . . . to meet the problems and eliminate the evils as enumerated in this section" including Section 1(b)(4). (Sec. 1(c))

It was against this background that the Commission determined that the statute was designed to require that properties unrelated to the operations of a retainable utility system must be disposed of. Clearly this view is justified. The petitioners point to the additional standards in the second "other business" clause requiring that a retainable non-utility business be found "necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such [integrated] system or systems" (Sec. 11(b)(1).)

It seems clear that this requirement does not contradict the test of relationship to utility operations but rather supplements it. The Commission believes that the language of the section and its legislative history indicate conclusively that Congress regarded retention of businesses not related to the operations of a retainable utility system as not in the public interest or in the interest of investors or consumers and as detrimental to the proper functioning of the retainable utility systems. Petitioners contend, however, in contradiction of the language and the legislative history, that the language concerning relation "to the operations" of a

retainable utility system must be ignored and that the standards of public interest and protection of investors and consumers and detriment to the proper functioning of a utility system must be applied in the abstract and without relation to the operation of a retainable utility system. They have, thus, urged a standard, indefinite in content and unrelated to the purposes of the statute.

In an effort to support this standard they rely on three provisions of earlier drafts of the Senate bill. Since all of these provisions were subsequently rejected or substantially modified, the legislative history involves repeated refusal of the Congress to accept the tests proposed by petitioners and a Congressional insistence on the position applied by the Commission. First, petitioners cite a provision of an early Senate bill⁴⁸ whose language would permit the retention of certain businesses of the type claimed by petitioners provided retention was authorized under state law.⁴⁹ This provision was, however, soon abandoned in favor of a test requiring relation to the operations of an integrated utility system. Certainly, any inferences from these facts point against rather than toward petitioners' construction.

Petitioners further attempt to trace the alleged "origin" of the other business clauses to another section of the same early draft. An examination of the text of this bill in the light of subsequent changes indicates an intentional

⁴⁸ Section 8(a) (2), S. 1725, 74th Cong., 1st Sess., quoted in Pet. B. p. 64, footnote.

⁴⁹ The provision in question, Section 8(a) (2) of S. 1725, introduced February 6, 1935, and quoted in Pet. B., p. 64, permitted the retention of "any other business carried on by a public utility exclusively in a State or States where the carrying on of such business by such (holding company or subsidiary) company is expressly authorized by the State Commission." This provision, even if it had been embodied into law, would not permit the retention of the El Paso transportation and toll bridge properties which petitioners claim, for the businesses are in part carried on in a foreign country and in remaining part in the State of Texas, where no State Commission has the power required by the provision.

change in purpose and the adoption of the test applied by the Commission.⁵⁰

Petitioners then seek to draw comfort from an amendment by Senator Minton which would have permitted the retention of businesses affected with a public interest whose rates were regulated by law where the retention of such interest was not detrimental to the proper functioning of an integrated public utility system. Since this language was abandoned in the final bill, it is of doubtful relevance to the present construction of the statute. However, petitioners contend that this amendment indicated an intention to permit water and transportation properties to be retained and

⁵⁰ Petitioners' inference is drawn from the language in Section 8(a)(3) of the original Senate bill, S. 1725 (74th Cong., 1st Sess.). Under this draft, a holding company is permitted to retain only (1) interests in a gas or electric utility [Section 8(a)(1)], (2) any other business carried on by a public utility which is expressly authorized by a State Commission [Section 8(a)(2)], and (3) "such other businesses reasonably incidental to the foregoing as the Commission . . . may permit as necessary or appropriate in the public interest or for the protection of investors or consumers and not in contravention of the provisions of this Act" [Section 8(a)(3)]. An interpretative report, accompany the original S. 1725, refers to these provisions as designed to harmonize the statute with any State policies fostering the carrying on of traction or water businesses by utilities (Hearings before the Senate Committee on Interstate Commerce, S. 1725, p. 55-56, 1935). Petitioners infer that the intent ascribed by the interpretative report to Sections 8(a)(2) and 8(a)(3) is imported into Section 11(b)(1), because both Section 8(a)(3) and Section 11(b)(1) refer to reasonably incidental businesses and contain the general standards of public interest. This, of course, is fallacious. The provisions of Section 8(a) aided in carrying out the policy referred to in the interpretative report because they expressly provided for retention of utility properties authorized under State law, and not because of the "reasonably incidental" clause or the general test of public interest. When Section 8(a)(2) was removed from the bill, the language of Section 8(a)(3) was placed in juxtaposition with a test of relationship to electric and gas operations alone. This clearly evidenced abandonment of the earlier intention to conform to any State policy which might authorize the retention of traction and water properties.

point to the fact that the amendment was accepted by Senator Wheeler, who was in charge of the bill. However, the language of the amendment itself and Senator Wheeler's statement indicate that such properties were not retainable even under the Senate bill before it was redrafted in conference, if detrimental to the proper functioning of a retainable integrated utility system. Senator Wheeler's statement is significant:

"Mr. Wheeler: Mr. President, let me say to the Senator that I have examined the amendment and I have not any particular objection in a geographically integrated district to a holding company having a water company or some other company which is regulated by a public commission and which it has at the present time, *but we do, under the bill, propose to prevent them even in this instance, from keeping those that they have if the Commission finds that their retention is detrimental to the public interest*" (79 Cong. Rec. 8849, June 7, 1935).

It is clear from the statement quoted in connection with the House bill ⁵¹ that Senator Wheeler regarded the retention of properties which were not related to the functioning of an integrated public utility system as detrimental to the public interest. The Commission properly held that the rejection of the Minton amendment in conference involved a clear adoption of the general test of relation to the operations of a retainable utility system and an equally clear rejection of the test of regulation of rates as of major relevance to the retainability of other businesses.⁵²

Examination of the legislative history serves merely to reinforce the conclusions arrived at by an examination of the language of the statute, the policy set forth in Section 1(b)(4), and the decision of the *North American* case. The conclusion is inevitable that the Commission properly re-

⁵¹ *Supra*, pp. 38-39.

⁵² It should be noted that the ice and appliance businesses held retainable under the present test would not have been retainable under the Minton amendment.

quired as a condition to retainability that other businesses must be related to the "operations" of a retainable utility system.

2. The Commission Properly Rejected Petitioners' Contentions on the Retainability of the Transportation and Toll Bridge Businesses.

The absence of any relationship between the Virginia transportation and El Paso transportation and toll bridge businesses, on the one hand, and the respective electric utility systems, on the other, was explicitly admitted by petitioners' witnesses.⁵³ In their effort to make a case for the retainability of these properties, petitioners advanced several other arguments, none of which was relevant to the statutory requisite of a relationship to utility operations, and which were in themselves fallacious as well. These arguments may fairly be summarized as follows: (1) that there is an historical association between the transportation and electric properties; (2) that separation would entail certain increased expenses to the electric system; and (3) that the properties are worth more to Virginia and El Paso than they would be to a purchaser ⁵⁴ (Pet. B. 74-82, 111-115).

The mere statement of these contentions discloses their irrelevance to the issue of whether the transportation businesses are related to the operations of the electric systems.

The historical relationship between utility and non-utility properties was precisely what the Congress intended to sever in the enactment of the Holding Company Act, and it certainly cannot be regarded as a reason for continuing such an association. And, of course, the historical associa-

⁵³ *Supra*, pp. 35-36.

⁵⁴ These same three assumptions underlie petitioners' argument in the case of both Virginia and El Paso. For this reason both properties will be treated jointly in the following discussion, with appropriate record references to both.

tion has no bearing on the question of relationship to utility operations.⁵⁵

The alleged increased expenses arising on divestment were found by the Commission to be grossly exaggerated. Petitioners here have fallen into errors of the same nature as were exposed in the discussion of the retainability of the Virginia gas system. The record does not support petitioners' claim that additional compensation would have to be paid to electric employees in lieu of their present free transportation privileges⁵⁶; on the contrary, there is likely to be an actual saving.⁵⁷ The other alleged increases in payroll are shown by the record to be due, not to the severance of the transportation businesses, but to the anticipated expansion of the electric system.⁵⁸ Nor does the record sustain

⁵⁵ The argument of historical association and of savings from joint employees and facilities was made to the Commission and the Court in *The North American* case and was rejected. See *The North American Company*, — S.E.C. — (1942), Holding Company Act Release No. 3405, p. 26, aff'd, *The North American Company v. Securities and Exchange Commission*, *supra*.

⁵⁶ The recent history of petitioners discloses that when they disposed of transportation properties, or *even when they transferred one to a separate corporation within the holding company system*, utility employees lost their free transportation privileges but were paid no compensating salary increases (Resp. App. 46-47). Such also, was the experience of El Paso's employees when the company abandoned its policy of giving them reduced electric rates (Resp. App. 54-56). Despite petitioners' "declared conviction" (Pet. B. 113, 79) that increased compensation would be necessary, not one example has been cited, from petitioners' companies or elsewhere, to show that such increases have ever actually been made.

⁵⁷ Since from the record it appears that the employees' salaries will not be increased, savings will result to the electric systems, since they presently enter a charge on their books for the free transportation. At the same time that this saving accrues to the electric systems the transportation businesses will have actual cash fare receipts instead of the present book-keeping entries (Resp. App. 50).

⁵⁸ Petitioners' witnesses testified that the time of such former joint employees would be taken up completely in the

the contention that the electric system's assumption of pensions due former transportation employees would result in increased expenses.⁵⁹

Petitioners present an elaborate hypothetical contention that retention of the transportation properties will result in "salvaging" their existing investment in these properties. They argue that this could not be done by divestment (Pet. B. 79, 114). When reduced to simple terms, this amounts to an argument that the dollars of income from their transportation properties are worth more to them than to a purchaser. The short answer is that while petitioners regard such value as available exclusively to them-

(Footnote 58 continued)

expanding electric operations. Thus it was testified with respect to Virginia that "the growth in electric will take up all the slack" (Resp. App. 45) and "the rapid expansion and growth of the electric department will assure a full day's work for all executives in the company" (Resp. App. 44-45). As to El Paso, see Resp. App. 49. In any case, one of the two outside expert witnesses produced by petitioners testified that the clerical work for the electric and transportation business is so different and distinct in character that no time is saved by performing them jointly (Resp. App. 53).

The anticipated expansion of the electric system, similarly, would absorb the alleged increased expenses due to cessation of use of joint building space and equipment (Resp. App. 45). It was conceded that the present joint use of poles and conduits could be continued on a rental basis, so no increased expenses would in fact result (Resp. App. 36, 45-46, 48).

⁵⁹ Either the pensions would be assumed by a purchaser of the transportation properties as a necessary expense to be borne by the business, or the value of the transportation properties would be enhanced by the fact that their operating expenses did not include pension obligations (Resp. App. 50). These are the only two possibilities. Under the first, there is obviously no expense to the electric systems; under the second, the sale price provides the fund with which the electric systems would pay the pensions they assumed. Significantly, in the case of El Paso, petitioners now compute "economies" on the assumption that continuance of pensions would not be an increased expense (Pet. B. 113).

selves, there is no reason why a purchaser could not realize it as well.⁶⁰

The foregoing analysis has demonstrated how nebulous and unfounded are petitioners' contentions. Even apart from their irrelevance to the statutory requirement that the businesses be related to utility operations, the Commission would not be justified in giving weight to such contentions.

Furthermore, the record compels the conclusions arrived at by the Commission. For, not only did petitioners' witnesses show how totally unrelated the transportation businesses⁶¹ are to the operations of the electric systems, but

⁶⁰ Petitioners' hypothesis turns on their opinion that securities could not be issued to finance a street railway acquisition and that a purchaser would therefore immediately convert all railway properties into bus properties. There are four simple, separate answers to this contention: (1) Both transportation businesses are small enough so that their purchases could easily be financed without the issuance of securities; (2) securities could be issued primarily against the bus properties alone, but since the investor would also be secured by the railway revenues, the security would be doubly attractive; (3) the securities could be issued to private buyers and not sold to the public; or (4) the transportation properties could be sold to the municipalities served.

A further basic fallacy inheres in petitioners' assumption that the dollars of transportation income are of lesser value to a purchaser than to themselves. While they compute the annuity value of the transportation income to themselves at 6 per cent, they estimate a purchase price on the basis that a purchaser would demand a $16\frac{2}{3}$ per cent return on his investment. If, in fact, the risks of non-receipt of income of the transportation businesses are such that it is necessary for an investor to require a return of $16\frac{2}{3}$ per cent, it is inescapable that the discount rate of 6 per cent as used by petitioners to determine the value of the property to themselves fails to take into account the very same risks.

⁶¹ The record also shows that the demand for energy of the Virginia transportation business is only 3.9% of the electric system's output (Resp. App. 37). The railroad load of the El Paso electric system is also an insignificant portion of the total electric load (Resp. App. 49-50).

Each of the two transportation businesses is operated by just one man who, in the case of El Paso, was brought in

they testified to the existence of abuses in the combined operation of the electric systems and transportation businesses. Thus, there has been no proper segregation of railway and electric property between the respective plant accounts (Resp. App. 37, 48); there has been no segregation of depreciation accrual among the respective operations (Resp. App. 12, 47-48); there have been continued improper allocations of charges for joint and interdepartmental services;⁶² and, despite new methods of allocation of charges, which appear to have been prompted by the Commission's institution of these proceedings pursuant to Section 11, the improper allocations are to an extent still continuing (Resp. App. 48). These practices have resulted from the historical association of the electric and transportation properties and their joint operation—the very factors relied on by petitioners to justify the transportation properties' retention. The Commission found that, in the case of both Virginia and El Paso, the effect of such practices has been adverse to the protection of investors and consumers and has been detrimental to the electric system (*Cf.* Resp. App. 11-12, 43-44). Thus even the criteria which petitioners regard as the sole tests of the retainability of the transportation properties were not met, and even on petitioners' assumption as to the meaning of the statute, the divestment of these properties would be required.

(Footnote 61 continued)

specifically for that purpose (Resp. App. 50-51). As for Virginia it was conceded that company officers devote only a nominal amount of time to the transportation business (Resp. App. 44).

⁶² As one example, the street railways have been charged too little for the electric energy they used. The study which petitioners had prepared in 1940 for Virginia showed the more profitable electric operations being excessively charged in the amount of \$113,378 (Pet. App. 842). The reallocation study for El Paso also proposes a net credit to the electric system in the amount of \$29,124 (Engineers' Exhibit No. 174, R. pp. 7484-7494).

Fundamentally, however, this evidence serves to corroborate the Commission's conclusion that the standards of the first and second "other business" clauses are basically interconnected; that the retention of a business not related to the operations of a utility system was regarded by Congress as contrary to the interests of the public, consumers and investors, and detrimental to the proper functioning of the utility system; and that the divestment order with respect to Virginia's transportation and El Paso's transportation and toll-bridge businesses was proper in every respect.

D. THE COMMISSION PROPERLY ORDERED THE DIVESTMENT OF THE GAS AND WATER PROPERTIES OF GULF AND THE BATON ROUGE BUS PROPERTIES.

In its opinion the Commission made advisory findings to the effect that, if the Gulf electric system were retained as the single system of Engineers, Engineers could not retain with it the gas system and water properties of Gulf and the Baton Rouge bus properties. The petitioners seek review of these findings and have briefed the point. However, the Commission's order was based on the assumption that the Virginia electric properties and not those of Gulf would be the single system of Engineers. Petitioners did not avail themselves of the opportunity to request the Commission to designate Gulf's electric system as its single system and the Commission entered no order on that assumption. Petitioners' arguments are, therefore, not directed to the Commission's order of September 16, 1942, but merely to advisory findings which were never incorporated into an order. Since Section 24(a) permits a review only of orders of the Commission, the issue of whether the gas, bus, and water properties in question are retainable together with the Gulf electric system is not before this court and is not briefed here.

The Commission, however, did consider whether the Gulf gas and water properties and the Baton Rouge bus properties could be retained on the assumption that Virginia electric system was the single system of Engineers (Pet. App. 153-54). On that assumption it seems clear that these properties do not meet the necessary standards as retainable additional systems or other businesses with relation to Virginia and, indeed, no such contention was made by petitioners. On the assumption that petitioners' principal system is to be the Virginia electric system, which is in fact the basis of the orders here under review, the Commission's order for divestment of these properties is entirely proper.

E. THE COMMISSION'S DESIGNATION OF ENGINEERS' PRINCIPAL SYSTEM WAS PROPER.

Under Section 11(b)(1) the Commission has the power and duty to require "as soon as practicable" such action as "it shall find necessary" to limit the operations of holding-company systems as prescribed by that section. The statute does not further define the nature of the orders which the Commission must issue to effect compliance with Section 11(b)(1). Accordingly it is necessary that this Commission in each case determine what type of order is appropriate to the particular circumstances before it.

It therefore seems clear that under the Act the Commission is authorized, under appropriate circumstances, to select the single system contemplated in Section 11(b)(1). It found in this case that such action by it was appropriate. It designated the single system, however, only after Engineers was given every opportunity to make its own selection but failed to do so.

Petitioners do not urge that in selecting Virginia the Commission chose the wrong system; nor do they contend that Gulf or any other system should have been selected instead. Petitioners argue, however, that the Commission has no authority to make a selection of the principal sys-

tem, at least during the period set forth in Section 11(c) for compliance with orders under Section 11(b). The same contention was made and rejected in *The North American Company v. Securities and Exchange Commission*, *supra*. The reasoning of the Court in that case is equally applicable to the case at bar. The Court there said:

“We now turn to the petitioner’s contentions relating to the interpretation and application of Section 11(b)(1). The first is as to selection of a single integrated public utility system to be retained (which may conveniently be called the ‘principal’ system). The selection of a principal system must naturally precede any final determination of what ‘other businesses’ are ‘reasonably incidental or economically necessary or appropriate to the operations of such’ principal system, as well as what ‘additional integrated public-utility systems’ the holding company is to be permitted ‘to continue to control.’ Where, as in this case, there are found to be several integrated public utility systems, any one of which might reasonably be chosen as the principal system, is the choice to be made by the holding company or by the Commission? We may assume, without so deciding, that the privilege of selecting its principal system should, during preliminary stages of the Section 11(b)(1) proceeding, be accorded the holding company. This was done and only after North American had refused to express a preference between the several integrated public utility systems, was the St. Louis system selected by the Commission as the principal system for retention. No contention is made that the Commission made an unreasonable selection or that the selection of a different system would be more beneficial to North American. Its argument is merely that it cannot now tell which two of the three systems (St. Louis, Cleveland and Wisconsin) will be most marketable; that Section 11(c) gives it at least one year for compliance with the divestment order; and therefore it may select its principal system at any time within the period allowed for compliance. We do not think the statute contemplates such deferment of selection. It would necessarily result in delays. The

Commission's duty is to act under Section 11(b) 'as soon as practicable,' and due diligence in complying with the order is prescribed by Section 11(c). Nor do we see that deferment in selecting the principal system is necessary to adequate protection of a holding company against circumstances which may arise during the period allowed for compliance with the order. If changes occur in 'the conditions upon which the order was predicated,' the Commission is authorized by subsection (b) to revoke or modify any order previously made thereunder. Under the circumstances disclosed by this record we see no error in the Commission's selection of the St. Louis system as the principal system for retention."

As indicated above, p. 11, certiorari has been granted in *The North American* case, but the request by The North American Company was limited to questions of constitutionality and no appeal has been taken from this quoted portion of the Court's opinion.

It is submitted that the cases are identical in all respects. As in *The North American* case, no action of the Commission prevented Engineers from making its own selection of a principal system. It could have made its choice in a voluntary plan for compliance under Section 11(e), but failed to do so. It failed to do so again in response to a show cause order at an early stage of the proceeding. Instead it requested the Commission to make advisory findings on the alternative assumptions that either the Gulf or the Virginia electric system was to be its principal system. After the Commission made such findings and designated Virginia as the principal system, Engineers still had two 15-day periods in which the choice was still open to it. (The North American Company had one such period.) Engineers nevertheless failed to make its selection. As in *The North American* case, petitioners here do not contend that the Commission's designation of Virginia as the principal system is incorrect or that they would have chosen Gulf as the principal system had

the Commission's order not been couched in its present terms.⁶³ The ruling in *The North American* case should be applied here.⁶⁴

⁶³ Petitioners have represented to the Commission that the provisions of the Federal income tax laws permitting the filing of consolidated returns result in substantial tax savings through the filing of a consolidated income tax return by Virginia and Engineers. Engineers' interest in Gulf is not sufficient to permit the filing of a consolidated income tax return with Gulf (Resp. App. 2-3). In view of these facts, it would seem that the insistence upon further time to elect as between Gulf and Virginia is made purely for strategic purposes.

⁶⁴ Petitioners seek to distinguish *The North American* case on the ground that, in that case, advisory findings with respect to the properties retainable with several alternative principal systems had not been made, and that the making of such findings by the Commission would have delayed the issuance of an order of divestment. In the present case they contend that the advisory findings have already been made and that such delay would, therefore, not occur. Petitioners, however, disregard the fact that a delay consequent upon the making of advisory findings is not the only type of delay against which the Commission is required to guard, nor is such delay specifically mentioned by the Court. An alternative order, such as petitioners here request, would also be a fruitful source of delay, for a holding company might find an excuse to divert time and energy from the disposition of properties required to be divested to the selection of its principal system. Finally, should the petitioners at any time find it more advantageous to dispose of Virginia rather than Gulf, the Commission's order does not prevent a disposition of Virginia, and obviously such a disposition would be a material change in circumstances. Thus the Commission's power to revoke or modify its order because of changed conditions provides adequate protection to the petitioners.

Similarly, there is no ground for petitioners' assertion that Section 11(b)(1) contains no standards to guide the Commission in designating the principal system. Section 11(b)(1) contains adequate standards. The Commission must find that the action it requires is "necessary to limit the operations of the holding-company system" in accordance with the specific standards of Section 11(b). Thus, the nature of the action to be taken by the Commission is set forth in specific terms, and the time for the Commission's action—"as soon as practicable after January 1, 1938"—is specifically set forth. The standards prescribed by Congress are so clear and definite as to leave no question as to the propriety of the delegation.

POINT II—SECTION 11(b) (1) OF THE ACT IS CONSTITUTIONAL.

Petitioners assert that Section 11(b) (1) is unconstitutional. They contend that (1) the provisions of that section bear no reasonable relationship to any proper objectives in the regulation of interstate commerce, and holding-company ownership of securities bears no substantial relationship to interstate commerce, and (2) the provisions of the section are not reasonably necessary or appropriate to eliminate the abuses which Congress found to exist in connection with holding-company systems, thus violating the Fifth Amendment. Neither of these contentions is tenable.

A. SECTION 11(b) (1) IS A VALID EXERCISE OF CONGRESSIONAL POWER UNDER THE COMMERCE CLAUSE.

The decision of the Supreme Court in *Electric Bond and Share Company v. Securities and Exchange Commission*, 303 U.S. 419 (1938), although confined to the provisions of Sections 4(a) and 5 of the Act, established two propositions relevant to this case: (1) that a corporation is brought within the reach of Congress under the Commerce Clause of the Constitution (Art. 1, Sec. 8, cl. 3) when it engages in the transmission of electric energy and gas across state lines or in rendering to subsidiaries through the use or instrumentality of interstate commerce expert and financial service or in the sale of securities in interstate commerce; and (2) that whether such activities are carried out by a holding company directly or whether they are carried out by subsidiary companies controlled by the holding company, a holding company is still within the reach of Congress under the Commerce Clause, for "the constitutional authority confided to Congress could not be maintained if it were deemed to depend upon the mere modal arrangements of those seeking to escape its exercise." *Id.*, at 440. Engineers has di-

rectly and through its subsidiaries engaged in the type of activities mentioned in the *Bond and Share* case. As stated above (pp. 3-4), it is not engaged solely in owning securities in various utility companies. It is a holding company controlling the operations of those subsidiaries. Since, as has been stated, control over utility subsidiaries is the essential characteristic of a holding company, under the *Bond and Share* decision the activities of the holding company and its subsidiaries are to be regarded for constitutional purposes as what in fact they are—the activities of a single enterprise.

The relation of Section 11 to interstate commerce is direct. Section 11(b) (1) ordering the limitation of holding-company systems to a single system applies only to registered holding companies. As shown above, only holding companies engaged in interstate commerce are required to be registered.⁶⁵

Petitioners, however, argue (Pet. B., 38) that the particular type of regulation adopted by Section 11(b) (1) is not reasonably related to a proper objective under the Congressional power over interstate commerce. The answer to this question lies in the determination of whether the continued control by a holding company over subsidiary corporations operating in distant areas so affects interstate commerce that Congress may order such control to be terminated or limited in scope. The Commission, of course, made no

⁶⁵ Furthermore, Section 3(a) (1) and 3(a) (2) of the Act provide a means by which companies predominately intra-state in character may obtain exemption from the Act. Engineers has not sought to obtain such an exemption and, of course, could not. Having registered and not having sought exemption from any provision of the Act, the Commission was entitled to assume, without express findings, that Engineers was a holding company interstate in nature and engaged in interstate commerce. And Congress was entitled to make a similar assumption as to all holding companies which register and cannot obtain any exemption from registration. It could, therefore, properly apply Section 11 to "each registered holding company" confident that registration was evidence of the interstate character of that company.

such finding, but such a finding was unnecessary and would have been improper since Congress itself had made the necessary findings.

The constitutionality of dispensing with specific findings in cases where Congress has found that the activities regulated have a direct effect on interstate commerce is well established. See *United States v. F. W. Darby Lumber Co.*, 312 U.S. 100 (1941), 120-121.

The Congressional findings are set forth in Section 1 of the Act. The Congress found that it was necessary to control public-utility holding companies because it found that such companies and their subsidiary companies were affected with a national public interest since, among other things, "their practices in respect of and control over subsidiary companies often materially affect the interstate commerce in which those companies engage" (Section 1(a)(4)) and the extension of "their activities" over "many States * * * make[s] difficult, if not impossible, effective State regulation of public-utility companies" (Section 1(a)(5)). Section 1(b)(4) further declares that the national public interest is or may be adversely affected "when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coördination of related operating properties."

The Congressional findings expressly incorporate by reference the facts found in a comprehensive 9-year study of the industry set forth in the ninety-odd volumes of the reports of the Federal Trade Commission and in the six-volume Splawn Report of the Committee on Interstate and Foreign Commerce of the House of Representatives. This material is outlined in a Supplement to our brief which we shall seek permission to file with this Court.

The evils set forth in the reports before Congress included inflationary write-ups on the books of operating companies complicating the regulation of rates; acquisitions of properties at grossly inflated prices; financing expansion by issuing excessive amounts of senior securities and in-

sufficient common stock capital, resulting in the abuses of excessive leverage and inequitable distribution of voting power; unduly favorable treatment, in the sale of such securities, to investment bankers, frequently affiliated; preoccupation of management with financial maneuvering rather than efficient production and distribution of gas and electricity and the meeting of local needs; extraction of excessive dividends to maintain top-heavy structures of holding companies, often leading to improper accounting practices, and coupled with exorbitant "service charges"; and, finally, concentration of economic power too large for local regulation and presenting dangers of monopolistic control. In Section 1(c) of the Act Congress declared it "to be the policy of this title, * * * to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title."

The elimination of public-utility holding companies, except within defined limits, was thus found by Congress to be the appropriate means of striking at these evils. Section 11(b) (1) insofar as it requires divorcement of holding-company control over more than a single integrated public-utility system (with exceptions not here pertinent) was one means of dealing with the evils of the holding company-operating company relationship; Section 11(b) (2), requiring the elimination of holding companies insofar as they constitute unnecessary complexities in the holding-company systems, is another means to the same end.⁶⁶

⁶⁶ The application of Section 11(b) (2) is before this Court in *Central and South West Utilities Company, et al. v. Securities and Exchange Commission* No. 8333.

The Congress found that control over subsidiaries by the holding company was exercised by means of interstate commerce and that the evils resulting were initiated and perpetuated by means of instrumentalities of interstate commerce. It further found that these evils affected the nature and volume of the interstate commerce in which the subsidiaries engaged. The studies before it convinced Congress that control by the holding company over its subsidiaries was the root of the evil and it therefore declared that the means to remedy the evil was the limitation of the permissible scope of the holding-company device. Section 11(b) (1), ordering divestment of properties unrelated to a single integrated public-utility system, is not only reasonably related to the desired end, but is, in fact, essential to its accomplishment. The divestment of scattered and unrelated properties will achieve the desired objective of concentrating the attention of management on the efficient operation of "related operating properties" in a single area or region unhampered by absentee control and by problems unrelated to its proper functions. It seems clear from these findings that the particular activity regulated—control through the instrumentality of interstate commerce of a nation-wide holding-company system—is within the reach of the federal power and that the type of regulation selected is reasonably designed to cope with the evils arising from the regulated activity. The Circuit Court of Appeals for the Second Circuit so concluded in *The North American* case, *supra*.⁶⁷

⁶⁷ Nor does Section 11(b) (1) violate the Tenth Amendment. The short answer to this contention is that "if the act is within the power confided to Congress, the Tenth Amendment by its very terms has no application." *Everard's Breweries v. Day*, 265 U.S. 545, 558 (1924).

B. SECTION 11(b) (1) DOES NOT VIOLATE THE
FIFTH AMENDMENT.

1. *Section 11(b) (1) Bears a Proper Relation to the Objectives of Congress and is Not Unreasonable, Arbitrary or Capricious.*

Our discussion of the Commerce Clause has indicated the evils which Congress found to exist and has shown that the means chosen were reasonably adapted to the objective of preventing a recurrence of those evils. As the Second Circuit stated "to eliminate existing conditions Congress considered it necessary to enact Section 11. The means selected are clearly adapted to the end in view".

In an attempt to support their contention that Section 11(b) (1) is not an appropriate method of abolishing the abuses which Congress found, petitioners refer in detail to other sections of the Holding Company Act and the Federal Power Act regulating specific activities and transactions of holding companies and their subsidiaries, and to quotations from the reports of the Securities and Exchange Commission and the Federal Power Commission, pointing to the effectiveness of such other regulations. This contention, however, fails to recognize that the sections other than 11(b) (1) are aimed at regulating future transactions by holding companies rather than at eliminating the existing conditions that Congress found adversely affect the national public interest. The Congress, had it desired, might have confined its remedies to the regulation of future transactions alone. It concluded, however, that this would be an inadequate solution and that, to achieve its purpose, it was essential that holding-company systems be broken up and limited as prescribed by Section 11(b) (1). In any event, however, the choice of whether or not it was desirable to allow these evils to continue until they were cured by the long-drawn-out process of regulating future transactions was a question for Congressional discretion, not one of Con-

gressional power. Since the means thus selected by Congress, as we have shown, are adapted to remedy a situation within Congressional power, it is clear that the appropriateness of the remedy is for Congress to decide and not for the courts. *Sunshine Anthracite Coal Co. v. Adkins*, 310 U. S. 381, 394 (1940).

An argument similar to petitioners' was presented to the Circuit Court of Appeals in *The North American Company v. Securities and Exchange Commission*, *supra*, and the Court said:

"Congress did not think it could accomplish its object solely by regulating future transactions, although many of the provisions of the Act apply only to them. . . . The wisdom of the legislation and the appropriateness of the remedy chosen is not the concern of the courts."

2. Section 11(b)(1) is Not Confiscatory.

There is no basis for petitioners' contention that because the statute requires the divestment of properties it is confiscatory.

Petitioners have referred to the "destruction of values" (Pet. brief, p. 35) which they allege would be entailed by a forced liquidation consequent upon the divestment order. Petitioners, however, ignore the fact that compliance with such orders is ordinarily made by means of reorganization plans of the type which was before this court in *Chenery Corp. v. Securities Exchange Commission*, 75 App. D. C. 374, 128 Fed. (2d) 303 (1942).⁶⁸ All such reorganizations are required to be made in accordance with a plan which must be "fair and equitable" (Sections 11(d) and 11(e)) and which must be passed on in this respect by the Commission and normally by the Federal District and Circuit Courts.

⁶⁸ The *Chenery* case was remanded by the Supreme Court, U.S. —, 63 S. Ct. 454, February 1, 1943, on a point unrelated to the compliance with Section 11(b)(1) through a reorganization plan.

In any case, the argument that petitioners would be deprived of their property rights is irrelevant where the question involved is whether the statute is unreasonable, arbitrary and capricious. *Nebbia v. New York*, 291 U. S. 502 (1934). It seems clear that the statute is not subject to attack on this ground. When Congress found that substantial evils affecting interstate commerce resulted from control over far-flung empires by public-utility holding companies (Section 1), it was not powerless to adopt an appropriate remedy even though the alteration of "vested" property rights might be required.⁶⁹

The divestiture requirement is a familiar one under the Clayton Act,⁷⁰ the Commodities Clause of the Hepburn Act,⁷¹ and the Packers & Stockyards Act.⁷²

An argument similar to the one here advanced by petitioners was also rejected by the Court in *The North American Company v. Securities and Exchange Commission*.

3. *The Proffered "Constitutional" Data Does Not Affect The Constitutionality of the Statute*

In the proceedings before the Commission, petitioners sought to introduce certain statistics and other data com-

⁶⁹ *Mugler v. Kansas*, 123 U.S. 623 (1887); *Austin v. Tennessee*, 179 U.S. 343 (1900); *Booth v. Illinois*, 184 U.S. 425 (1902); *Otis v. Parker*, 187 U.S. 606 (1903); *Louisville & Nashville Railroad Company v. Mottley*, 219 U.S. 467 (1911); *Rast v. Van Deman & Lewis Company*, 240 U.S. 342, 368 (1916); *Continental Insurance Company v. United States*, 259 U.S. 156 (1922).

⁷⁰ Act of October 15, 1914, c. 323 (38 Stat. 730), U.S.C., Title 15, Sec. 12 ff., *Federal Trade Commission v. Western Meat Co.*, 272 U.S. 554 (1926).

⁷¹ Act of June 29, 1906, c. 3591 (34 Stat. 584), U.S.C. Title 49, Section 1 (8), *U.S. v. Delaware & Hudson Co.*, 220 U.S. 366 (1909), *U.S. v. Lehigh Valley R. Co.*, 220 U.S. 257 (1911), *U.S. v. Delaware L. & W. R. Co.*, 238 U.S. 516 (1915).

⁷² Act of August 15, 1921, c. 64 (42 Stat. 159), U.S.C. Title 7, Sec. 181, ff., *Stafford v. Wallace*, 258 U.S. 495 (1922).

piled by one Merwin H. Waterman, professor of business administration at the University of Michigan. This data was compiled by Professor Waterman in the course of a study financed by respondent. It purports to show that the evils found by Congress to exist and recited in Section 1 of the Act do not in fact exist and that the Congressional findings are erroneous, arbitrary and capricious. The Commission excluded this material on the ground that it had no jurisdiction to entertain questions of constitutionality.⁷³ The excluded material has been printed by appellants as Vol. III of the Appendix to their brief.

The petitioners seek remand of the case for the taking of testimony but such remand is unnecessary in any event. If the court should desire to consider this material as part of the petitioners' brief, it may do so without further ado. In substance, the material is an economic brief dealing with the facts of an entire industry and not with the situation of the particular petitioners before this court. The general "facts" presented here are not of the type which can be tested by the trial technique. They are not evidence but are in reality part of the petitioners' brief on constitutionality. The court should not itself listen to a reading of the "testimony" or appoint a master to do so solely because it is presented in question and answer rather than narrative form. Cases cited by petitioner as permitting the taking of "constitutional evidence" deal with constitutional questions depending on the facts of particular situations such as whether a particular rate is confiscatory and not with general overall facts relating to an entire industry.⁷⁴

Technical reasons aside, remand would be improper because the proffered material could have no possible effect upon the constitutionality of Section 11(b)(1). Although petitioners may have the right to attack Congressional find-

⁷³ The Commission's ruling was clearly right. *Panitz v. District of Columbia*, 72 App. D.C. 131, 112 Fed.(2d) 39, 42 (1940).

⁷⁴ See Note, "Introduction Before Agencies of Evidence Bearing on Constitutional Issues," 1 Pike and Fischer, *Administrative Law*, Current Text, Sec. 45a, 22.

ings of fact, they do not have the right to burden this Court with data of a type utterly incapable of impeaching such findings.

As stated in Section 1(b), the Congressional findings were made "Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), the reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H.J. Res. 572 (Seventy-second Congress, second session) and otherwise disclosed and ascertained, . . ." The exhaustive nature of these studies has already been mentioned.⁷⁵ The F.T.C. study mentioned has been called "the most thoroughgoing investigation of an American industry that has ever appeared."⁷⁶ Moreover, the Act was passed after one of the most bitterly contested legislative battles in our national history, and Section 11 was the focal point of the controversy as to the appropriate scope of the Act.

Against this vast array of fact-sources, petitioners now seek to introduce the conclusions of a solitary professor of business administration, employed by petitioners to conduct a survey. Whatever may be the qualifications of this individual,⁷⁷ common sense dictates that he alone could not im-

⁷⁵ See pp. 55-56, *supra*.

⁷⁶ Barnes, *The Economics of Public Utility Regulation* (1942), p. 71.

⁷⁷ We make no special point of the statistical absurdities sprinkled throughout the study. Two examples will suffice. Comparison as to efficiency is made between independent companies and holding company subsidiaries without reference to the most essential factor, the size of the companies. The balance is weighted against the independents because 60% of these companies had annual gross revenues of less than \$250,000 a year while only 30% of holding company subsidiaries were that small. Further the "study" indicates that "independents" serve communities on the average more than twice as large as holding company subsidiaries. This average fails to indicate that six companies (some of them in fact holding company subsidiaries) account for a preponderant part of all the population served by all the "independents".

peach the findings of Congress made after such extensive consideration of so vast and controversial a field. Many of the Congressional findings are obviously conclusions and opinions, the truth or falsity of which cannot be definitely demonstrated by one opinion witness.⁷⁸ The words of Judge Hamilton in *R. C. Tway Coal Co. v. Glenn*, 12 F. Supp. 570, 582 (W.D. Ky., 1935),⁷⁹ are appropriate here:

"The Congress has already investigated the facts as a basis for its action. If its findings may be impeached by the testimony of opinion witnesses, the act might be found to be constitutional in one case and unconstitutional in another, depending on the testimony. As many conclusions might be reached as to constitutionality as there might be judges, or upon such facts as ingenuity might suggest as matters of opinion or actual facts in evidence."

In addition, the proffered data can have no real value. The undisputed facts revealed by the reports of the Federal Trade Commission and various Congressional committees, together with other facts within the judicial knowledge of this Court, show that the Congressional findings and enactments here involved are not arbitrary and capricious. In such a situation, courts must uphold the Congressional findings and enactments. As was said in *United States v. Carole Products Co.*, 304 U.S. 144, 154 (1938):

"Here the demurrer challenges the validity of the statute on its face and it is evident from all the consid-

⁷⁸ Notably is this true of the findings of Congress as to the effect of holding company control on effective state regulation of public utility companies and as to the effect of great concentration of economic power in holding company managements. Professor Waterman's treatment of the first point reveals its inadequacies on first glance (Pet. App. 1124). On the second of these points Dr. Waterman in 1932 made some pertinent observations not repeated in the study submitted. See Waterman *Financial Policies of Public Utility Holding Companies*, Michigan Business Studies (1932), p. 43.

⁷⁹ Reversed on other grounds, *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936).

erations presented to Congress, and those of which we may take judicial notice, that the question is at least debatable whether commerce in filled milk should be left unregulated, or in some measure restricted, or wholly prohibited. As that decision was for Congress, neither the finding of a court arrived at by weighing the evidence, nor a verdict of a jury can be substituted for it."

The Congressional findings which petitioners seek to attack clearly have a reasonable basis and are hence conclusive. There is thus no purpose to be served by the consideration of the proffered material.

CONCLUSION

The orders of the Commission should be affirmed.

Respectfully submitted,

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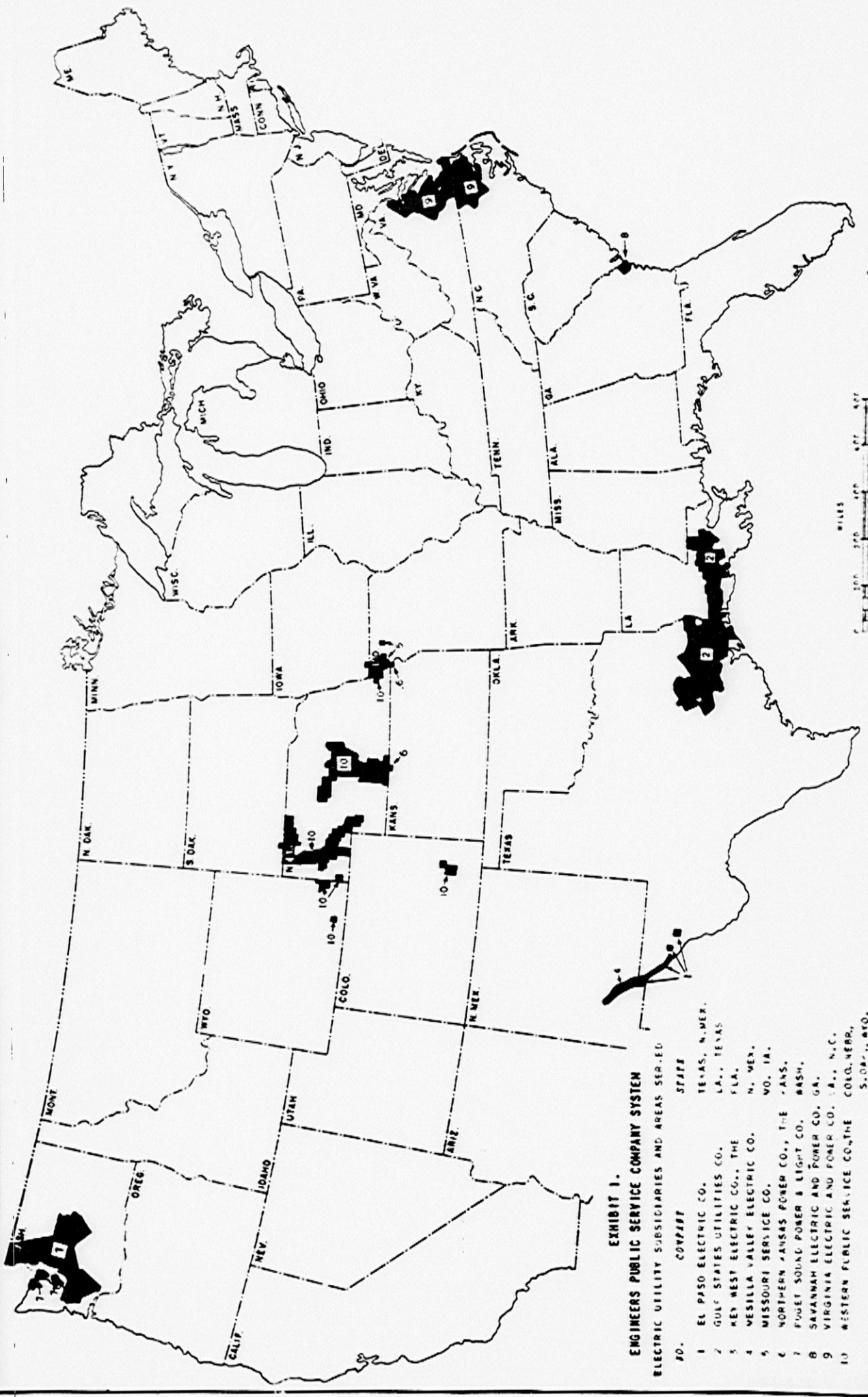


EXHIBIT 1.

ENGINEERS PUBLIC SERVICE COMPANY SYSTEM

ELECTRIC UTILITY SUBSIDIARIES AND AREAS SERVED

NO.	COMPANY	STATE
1	EL PASO ELECTRIC CO.	TEXAS, N. MEX.
2	GULF STATES UTILITIES CO.	LA., TEXAS
3	KEN WESS ELECTRIC CO., THE	FLA.
4	WESILLA VALLEY ELECTRIC CO.	N. MEX.
5	MISSOURI SERVICE CO.	MO. IA.
6	NORTHERN KANSAS POWER CO., THE	KANS.
7	FOUNT SOUND POWER & LIGHT CO.	MASH.
8	SAVANNAH ELECTRIC AND POWER CO.	GA.
9	VIRGINIA ELECTRIC AND POWER CO.	VA., N. C.
10	WESTERN PUBLIC SERVICE CO., THE	COLO. NEBR.
		S. DAK., WYO.

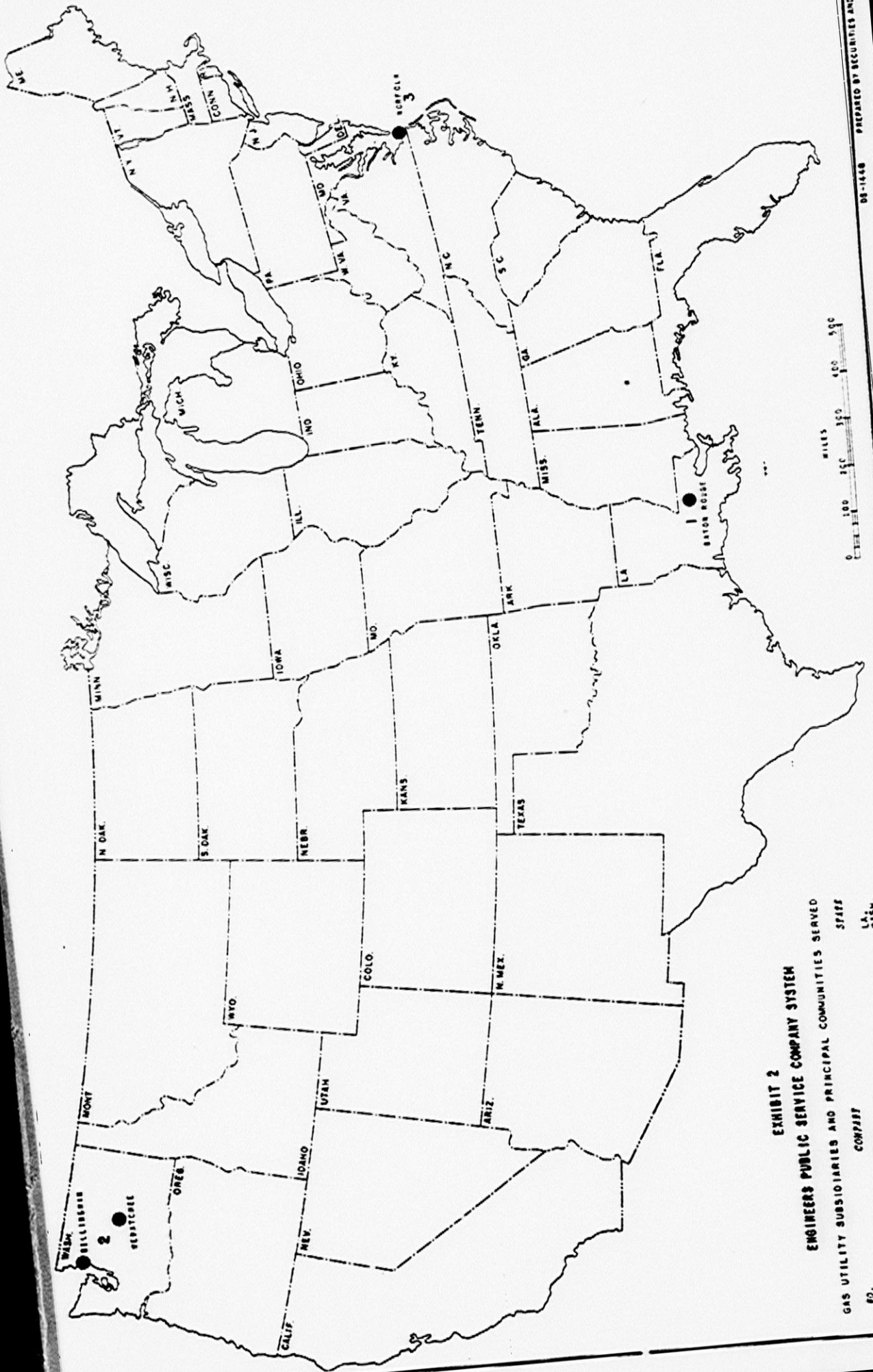


EXHIBIT 2 ENGINEERS PUBLIC SERVICE COMPANY SYSTEM

GAS UTILITY SUBSIDIARIES AND PRINCIPAL COMMUNITIES SERVED

COMPANY

LA. STATE UTILITIES CO.
PUBLIC SERVICE COMPANY OF CALIF.
NORFOLK ELECTRIC AND POWER CO.

STAFF
LA.
WASH.
VA.

PD.

1
2
3

ENGINEERS PUBLIC SERVICE COMPANY

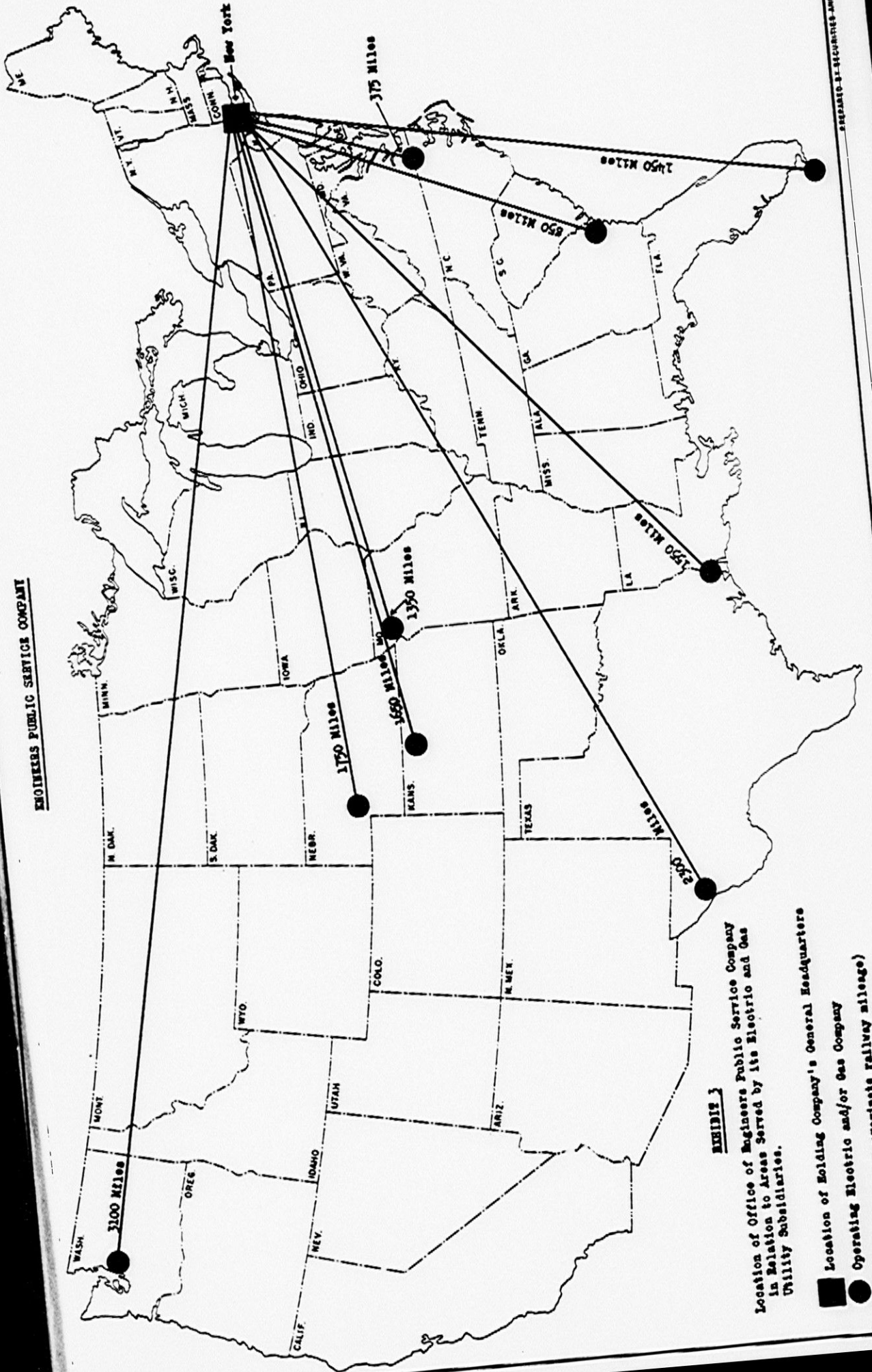


EXHIBIT 3

Location of Office of Engineers Public Service Company in Relation to Areas Served by its Electric and Gas Utility Subsidiaries.

- Location of Holding Company's General Headquarters
 - Operating Electric and/or Gas Company
- (Distances based on approximate railway mileage)

OFFICE COPY

APPENDIX TO RESPONDENT'S BRIEF

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA

UNITED STATES
COURT OF APPEALS FOR THE
DISTRICT OF COLUMBIA

No. 8394

FILED MAR 13 1943

Joseph W. Stinson
CLERK

In the Matter
of
ENGINEERS PUBLIC SERVICE COMPANY
and
ITS SUBSIDIARY COMPANIES

ENGINEERS PUBLIC SERVICE COMPANY, et al.,
Petitioners,
against
SECURITIES AND EXCHANGE COMMISSION,
Respondent.

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TO RESPONDENT'S BRIEF**

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EXCERPTS FROM THE TESTIMONY

THE HOLDING COMPANY

D. C. BARNES

Direct Examination

[R. p. 3968] A. The subsidiary companies of Engineers Public Service Company or their predecessors have been supervised by a central supervisory organization through several generations of executives, first under the supervision of Stone & Webster Management Division and later under its successor, Stone & Webster Service Corporation, and since May, 1931 under the mutual service company, Engineers Public Service Company, Inc. The dates when such supervision began for each of the companies or their predecessors are as follows:

Savannah Electric and Power Company	1901
El Paso Electric Company	1901
Baton Rouge Bus Company	1907
Gulf States Utilities Company	1907
Virginia Electric and Power Company	1925

[R. p. 3969] As a result, the present local organizations of these companies have been selected and trained for that method of operation and, while they are exceptionally competent and well equipped for that character of operation, none of them have had the training or experience required to qualify them to undertake the task of operating their properties without the supervision of competent and trained executives and experts selected because of their ability and judgment and who have had a breadth of experience in financial, operating, accounting and construction matters not available to men in the local properties. The present supervisory personnel of the mutual service company, each an expert in his respective line, were selected carefully from a large group of men who had been associated in the supervision of public utilities for many years.

D. C. Barnes—Direct Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

Through their services the mutual service company assures to its associated companies economical financing, the benefit of purchasing in large quantities, proper and systematic corporate records, proper and uniform accounting, computation and study of statistics of operation, availability of trained men to fill the needs of the operating companies and for the study and handling of specific problems, and the broad experience and consistent supervision impossible to isolated properties and indispensable to the most successful operation.

[R. p. 3970] Therefore, if the subsidiaries are to be divorced from the present mutual service company and if they are to be operated, developed and financed efficiently, arrangements must be made to strengthen their local organizations.

There are two alternative plans which could be followed to do this:

(1) By the employment of such personnel as will provide the requisite supervision; or

(2) To employ a service organization rendering suitable services of this nature.

* * * * *

[R. p. 4725] Q. Mr. Barnes, you stated that there was a second possible advantage tax-wise in having some holding company in the picture. Will you briefly develop this point?

A. At the present time a consolidated return for determination of excess profits taxes is filed including Virginia Electric and Power Company and Engineers Public Service Company. This will effect a saving in Federal taxes to Virginia on the basis of 1941 earnings of some \$72,000 annually. If, as the President has recommended, Congress eliminates the [R. p. 4726] alternative in the present tax bill which permits the use of the average earnings base and thus limits exemption to that determined by the use of invested

D. C. Barnes—Direct Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

capital, such a consolidated return would save approximately \$425,000 for Virginia Electric and Power Company. At the present time Engineers has an investment of over \$34,000,000 in Puget Sound Power & Light Company. If Puget Sound Power & Light Company is sold the difference between this amount and the proceeds from such a sale would increase correspondingly the amount of the allowed invested capital in the consolidated excess profits tax return. For each million dollars of such increase in invested capital a net saving in Federal taxes of \$29,000 would be realized. It is, therefore, apparent that whether or not the optional use of the average earnings base for determination of excess profits tax liability is eliminated, and even with the most optimistic estimate of realization from the sale of its investment in Puget Sound Power & Light Company, the increase in the invested capital base resulting from such a sale will be such that a further very substantial saving will be realized through Engineers for Virginia in its excess profits tax liability. I want to point out that a utility earning no more than a fair return may be subject to a substantial so-called excess profits tax. No fair comparison can be made between invested capital under the Revenue Act and the rate base. For example, invested capital gives [R. p. 4727] recognition to only 50 percent of the investment represented by debt. Furthermore, the excess profits tax is in no sense a tax on excess profits for it is applied to the taxable income before deduction of normal Federal income tax.

In the alternative if Engineers retains Gulf States Utilities Company and El Paso Electric Company, similar substantial excess profits tax savings could be realized through consolidated returns if the voting preferred stock of Gulf States Utilities Company were refunded with non-voting securities. It is apparent, therefore, that these tax advantages are substantial, and deserve recognition in considering any plan for the disposition of these properties.

* * * * *

D. C. Barnes—Cross Examination

THE HOLDING COMPANY (Cont'd)

D. C. BARNES

Cross Examination

[R. p. 4552] Q. Do you think that if Virginia Electric and Power Company were an independent company that Mr. Holtzclaw, a president at \$20,000 a year, could not be obtained who would not be qualified? A. No, I do not think, if Virginia were an independent company, it could provide the degree of supervision that it should have by the employment of such an executive.

Q. You believe, do you, that Mr. Holtzclaw has extensive experience in public utility operation? A. Yes, he has, under the supervision of a service organization.

Q. I do not quite understand that, Mr. Barnes. You say, he does have extensive experience under the supervision of a service organization? A. My statement was that Mr. Holtzclaw has had extensive experience in public utility operations under expert supervision.

Q. Well, he has had wide public utility experience? A. In properties which were supervised by a service [R. p. 4553] organization.

Q. In other words, if I state your mind correctly, it is that all the executives of the companies in the Engineers system have, from the inception, operated under supervision from New York, so that none of them would be qualified to operate the companies on their own? A. That is correct.

Q. And that is largely because they have not been given the opportunity, would you say, to assume the responsibility which is at present referred to New York? A. That is the fundamental reason; they must first have the opportunity, and when they have the opportunity, they shall demonstrate their ability to perform.

Q. You do not think that Mr. Holtzclaw had demonstrated his ability to perform adequately so as to be qualified for the presidency, or be qualified to operate Virginia Elec-

D. C. Barnes—Cross Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

tric and Power Company, if independent? A. I do not think he has ever had the opportunity to demonstrate whether he has such ability or not.

Q. And likewise, Mr. Montell Smith, vice-president of Virginia Electric and Power Company, has had very wide experience in the operating of public utility companies?

A. He has, under the supervision of a service organization.

Q. The same applies for Mr. Throckmorton and Mr. Jones, [R. p. 4554] vice-president of Virginia? A. That is correct.

Q. Who is Mr. Joseph Chase? A. Mr. Joseph Chase is a vice-president of Virginia Electric and Power Company stationed at Roanoke Rapids, North Carolina, and in charge of the operations of the company in that area.

Q. In charge of the North Carolina division? A. Of the North Carolina division.

Q. The same applies to Mr. Chase, that is, he is likewise— A. (Interposing) The same applies to Mr. Chase, he is thoroughly competent for the work he is doing.

Q. Do you believe it will be advisable—I believe you previously testified—to have supervision over all these executives with their widespread experience, if Virginia were independent?

The Witness: Read the question.

(Whereupon, the pending question was read by the reporter.)

The Witness: The question sounds a little involved to me, but I testified that if Virginia Electric and Power Company were to be an independent company, I think it would be advisable to either reinforce the Virginia organization, or to employ a service organization.

Q. In other words, to reinforce the local staff to [R. p. 4555] supervise the present executive staff of Virginia? A. That is correct.

Q. And why would it not be advisable to have a super-structure or super-staff over the reinforced staff of Vir-

D. C. Barnes—Cross Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

ginia Electric and Power Company to supervise this supervisory staff? A. I do not know why we should not have a President over the President of the United States, if that line of logic is to be pursued.

Q. Well, exactly, Mr. Barnes, what in your opinion would an executive with broad utility experience do with respect to the operations of Virginia Electric and Power Company which Mr. Holtzclaw, Mr. Montell Smith, Mr. Throckmorton, and Mr. Jones and Mr. Chase would not be qualified to do? A. He would do a great many things they are not qualified to do. He and the staff which we have proposed, would provide the services which are now being provided by the mutual service company, which services none of the existing staff organization of Virginia Electric and Power Company are qualified to undertake.

Q. Well, exactly what, with respect to the operations of Virginia Electric and Power Company, if it were independent, would— A. (Interposing) I introduced in my direct testimony Engineers' Exhibit No. 229, which outlines in considerable [R. p. 4556] detail the nature of the services furnished by the mutual service company. It is service of that character that this reinforced staff would provide and which the existing staff of Virginia Electric and Power Company are not at present equipped properly to provide.

Q. The mutual service company obtains the expert executives from the operating companies, does it not? A. That is correct.

Q. When they reach the necessary point of efficiency in the operations of various subsidiaries of Engineers, and an opening exists in the mutual service company, they are taken up into the mutual service company? A. That has been the history of the mutual service organization.

Q. And are the large executive staffs— A. (Interposing) Large, did you say?

Q. My question is, are the large executive staffs in the operating utility companies of the Engineers system any

D. C. Barnes—Cross Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

more qualified because they happen to be in New York than if they were in Richmond or Savannah or Baton Rouge?

A. The executive officers of the mutual service company in New York are men who, by their work in the field, have demonstrated good judgment, intimate knowledge of the business,—who have had broad experience and been successful in operating public utility companies; they have been brought in to the [R. p. 4557] central organization as a result of that trying out or distillation process in which the best are selected from those available, and, in New York, had a broad experience over a long period of time which has given them the training and ability to make decisions which men in the field without that experience or ability or judgment are not competent to undertake.

Q. The men in the field, however, who are the executives of the various subsidiaries of Engineers Public Service Company, are thoroughly qualified as utilities operators? A. They are thoroughly qualified to operate utilities under supervision of the character which they now have.

Q. Mr. Barnes, is it not quite a fair thing to say that some day Mr. Holtzclaw will be promoted to the ranks of the mutual service company? A. I think that question presupposes the continuance of the mutual service company.

Q. I was making that assumption. A. It seems to me that in view of the circumstances that exist, that is not a reasonable assumption.

Q. Let us assume, for the purpose of my question, that the service company is going to continue to exist. Is Mr. Holtzclaw the type of executive who, in the normal course of events, would eventually be elevated to the service company? [R. p. 4558] A. Yes, I think if the mutual service company were to continue, and if we needed additional men in the mutual service organization, Mr. Holtzclaw would be brought in as one of the staff, but he would not be given, in the beginning, until he had accumulated a substantial

D. C. Barnes—Cross Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

amount of experience, a final voice in the making of decisions of policy and other important questions.

Q. Your own training was in an operating company, was it not? A. It was.

Q. You were operating head of the Puget Sound Power and Light Company, were you not? A. I was the head of the Central Division of Puget Sound Power and Light Company.

Q. What office did you have? A. The office was that of manager of Puget Sound Power and Light Company, Central Division,—at the time I came back to Boston, at that time, I was made a vice-president of Puget Sound Power and Light Company.

Q. And then you were promoted to the service company? A. That was the time when I was promoted to the service company,—that was in 1924.

Q. And you were able to take some advisory duties on, at that time? A. I was given a position which might be described as [R. p. 4559] that of sponsor; about a year after I came back to the office—my first year at the Boston office, in that year I was assistant to a sponsor. The following year, I was made a sponsor, although that was not the title used at that time, but that describes the nature of the work.

Q. Did you experience any difficulty in working into your new duties? A. I had a long course of training, had over me men who had had long experience in supervising the properties,—had an opportunity to take up problems with them and get their advice over a period of 13 years,—I functioned as an assistant or vice-president in the supervising of operations of utility properties and financing.

Q. Has not Mr. Holtzclaw had long experience with executives of the service company? A. No, he has not been an executive, he has been a director in the service company, but he has not been an executive.

D. C. Barnes—Cross Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

Q. I understand that, but has he not had many contacts with Mr. Charles Kellogg, Mr. Cool, and the other top men in the service company, bearing in mind of course that Mr. Kellogg is now resigned? A. As the president of one of the subsidiary companies of Engineers Public Service Company, he has of course conferred with the men whom you mentioned, but he has not had [R. p. 4560] training in the supervision of operations of a number of utility companies.

Q. Well, how does the operating company executive acquire this proficiency? A. Acquire what?

Q. This proficiency of supervision. A. In our organization, they acquire it by being brought in to the supervisory headquarters and given more and more responsibility as their ability and judgment and experience warrant it.

* * * * *

L. F. YETMAN

Cross Examination

[R. p. 2989]

Q. Where are the reports to the Federal and State agencies, of your company, prepared? A. In El Paso.

Q. By the accountants of your company? A. Yes, of my department.

Q. And then they are sent to Stone & Webster Service Corporation for checking? A. No, sir.

Q. What happens to them then? [R. p. 2990] A. Those that we feel need review to determine that they comply with all the rules and regulations applying to the construction or preparation of the report,—they are sent to mutual service company's treasurer's department for review and any comments before actually filing them.

Q. Did the mutual service company make any changes in the report you sent to them covering the report to the

L. F. Yetman—Cross Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

Federal Power Commission for 1940? A. No. As I recall, of course, there were some few comments regarding the interpretation of certain questions, but our experience in El Paso now, having had the experience of preparing those reports since 1938, the first one of course being in 1938,—we are able to pretty much prepare the information as it is designed and called for in the report.

Q. Did you or your office in El Paso prepare the information with respect to El Paso Electric Company of Texas, contained in the annual supplement to the registration statement with this Commission? A. The El Paso office furnished to the treasurer's office practically all of the material necessary to the preparation of it.

Q. Where are the tax returns for your company prepared? A. They are prepared in the El Paso office.

Q. And then they are sent to the mutual service company? A. As I said in my testimony, they are sent to the [R. p. 2991] treasurer's office for review, to make certain that they are interpreting the Internal Revenue Act and any amendments thereto.

Q. Were there any changes made in the tax returns of your company for the year 1940 by the service company,—by the mutual service company? A. I think there were some suggested changes, I do not recall,—I would have to review our correspondence.

Q. Do you know if you proposed the payment of any different amount in taxes, in your statement as sent to the mutual service company, than is shown in the tax return as filed with the Internal Revenue Department? A. I do not recall that there was any change in the amount as we had computed it, and as checked by the treasurer's department.

Q. Does Stone & Webster Service Corporation render tax services? A. I believe they do.

Q. They do not render any tax services to your company, do they? A. No, sir.

L. F. Yetman—Cross Examination (Cont'd)

THE HOLDING COMPANY (Cont'd)

Q. Why do you not employ them for that purpose?

A. Because we get our tax service through the experts in the employ of the mutual service company.

Q. And also because you feel that your local staff is [R. p. 2992] adequately competent to prepare the tax return? A. Yes, with the advice and counsel of the tax experts in the mutual service company.

Q. Do you recall any year during the past three years in which the company, in preparing its tax return, proposed to pay a different amount of taxes than the amount that was paid? A. Within the last three years? Yes, I would say,—we were not quite positive of the treatment of certain abandonment losses arising from the discontinuance of certain street car lines, and the treasurer's department tax men advised us on the treatment of that particular kind of item.

* * * * *

VIRGINIA GAS

J. V. MITCHELL

Cross Examination

[R. p. 350] Q. It is correct, is it not, Mr. Mitchell, that the company's surplus is not earmarked as to whether it was [R. p. 351] derived from electric or transportation department? A. That is true.

Q. There is no means of telling, under the company's method of bookkeeping, as to whether or not there was or was not a transportation surplus at any given time? A. That is true.

Q. It is also true, to your knowledge, is it not, that electric rates are based in part on net income and on the net book value of the electric property? A. Yes, sir.

Q. And likewise the transportation rates are based upon the transportation net income and transportation net book value of the transportation property? A. Yes, sir.

J. V. Mitchell—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. And it is also correct that there is no method under the company's present method of bookkeeping of determining a net income from electric operations and the net income from the transportation operations?

The Witness: Will you repeat that question, please?

(Whereupon the pending question, as above recorded, was read by the reporter.)

A. Not without making certain provisions for charges, separation of charges, shown on the books.

Q. But there is no separation of certain of the important charges that the company makes—that is, separation [R. p. 352] between departments? A. That is right.

Q. So that, under the method of bookkeeping employed by the company, the amount of the departmental net income can not be determined? A. Not without making some separation of such charges for the particular purpose for which the net income is needed.

* * * * *

[R. p. 347] Q. But there wasn't that much depreciation charged, in fact, during 1938, is that correct, so that there was not a deficit in 1938 in the railway operation? A. The provision made in 1938 to the retirement reserve [R. p. 348] was made for the company as a whole, and was not separated between departments, so, in the absence of any separation between departments, of the appropriation to retirement reserve, which was made in 1938, I can't say what the balance after depreciation might have been.

* * * * *

[R. p. 4015] Q. For the combination electric customers in Norfolk, I am sorry, and 34 employees for the gas customers in Norfolk, and 30 employees for the single service electric customers in Norfolk and the electric customers in Portsmouth, or a total of 98, as against 90 employees presently employed to carry out that work. A. On the assump-

J. V. Mitchell—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

tion that it would require 34 employees to do the customers accounting work for approximately 30,000 customers, as shown in Exhibit 221, I based my estimates, all of my estimates, on the figures in that statement. On that basis, it would take 34 employees to do the accounting work for the 30,000 combination electric customers in Norfolk. It would take 34 employees to do the customers accounting work for the gas combination customers in Norfolk; and it would take approximately 30 employees, at least 30 employees, to do the customers accounting work for the single service electric customers in Norfolk and in Portsmouth.

Q. Now, if the gas department were independent, it [R. p. 4016] would take more employees to do the customers accounting and collecting work for the electric and gas customers accounting than is presently required? A. That is right.

Q. What would be the nature of the work of the additional employees? Would it be largely clerical? A. It would involve practically all phases of the clerical work; it would involve the reading of meters, the collection of accounts, the taking care of service contracts, and so on.

Q. The average compensation to that type of employee is about \$1,500 a year? A. It varies for the different classes of work.

Q. Would not \$1,500 a year for such additional employees be a pretty fair estimate? A. It may be. I do not have any figures on the average annual salary for the entire group of customers accounting department employees in the Norfolk and Portsmouth districts.

Q. Well, are not the salaries shown on page 2 of Engineers Exhibit 221 about the same salaries paid to the particular classes of employees shown thereon as the company presently pays? A. Yes.

* * * * *

[R. p. 4028] Q. You think that it would require two cashiers for the independent gas company; is that what I under-

J. V. Mitchell—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

stand? A. I said I did not believe that it could be done with any less than two.

Q. And you believe that there would be enough work to keep two cashiers busy, with practically no time available by such cashiers to do anything else? A. Well, they would have to do certain clerical work involved in connection with the collection of accounts, of course.

Q. Then, in your opinion, an independent gas company would require two cashiers who could also do some of that other clerical work? A. An independent company would require, I should say, two or three cashiers to do the work in connection with collecting customers accounts and the clerical work that is [R. p. 4029] strictly connected with the cashiers' work.

Q. You do not think that the independent gas company could get along with one cashier? A. I do not think so.

Q. You think they could get along with two? A. They could not get along with any less than two, I do not believe.

Q. But you do believe they could get along with two? A. They might be able to get along with two. Of course, there would undoubtedly be a certain amount of readjustment in the work. It would have to be fitted into the time.

* * * * *

[R. p. 4044] Q. What is the amount of the customers' billing and accounting expense for just the combination electric customers in Norfolk? A. I don't believe I have that figure.

Q. It would be \$9,700, wouldn't it, the same amount as for the gas customers? A. Will you repeat the question, please?

(The last question was read.)

A. Following through the reasoning the idea that if it costs \$811.89 to take care of the customers' billing and accounting work for a certain number of gas customers, it would take the same amount of money to take care of the accounting work for the same number of electric combination customers.

J. V. Mitchell—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. Then, in other words, it would cost \$19,400 for the customers' billing and accounting work for the electric and gas customers in Norfolk, who are combination customers, is that right? [R. p. 4045] A. By multiplying the \$9,700 amount shown on Exhibit 221, which applies to gas customers only — multiplying that by two — it would give \$19,400.

Q. Well, then, why should the cost for customers' billing and accounting for just the gas operation, if an independent company, cost more than customers' billing and accounting for both combination electric and gas customers in Norfolk? A. Because you do lose some efficiency with small volume.

Q. How much efficiency do you lose? A. I couldn't say.

Q. You don't lose more than 100 per cent efficiency, do you? A. No, sir.

* * * * *

[R. p. 4053] Q. At present the supervisor of accounting and collecting in Norfolk is in charge of both gas customers' accounting and collecting in Norfolk and electric customers' accounting and collecting in Norfolk and Portsmouth? A. That is right.

Q. And he devotes part of his time to gas as well as electric, and part of his time to Norfolk as well as Portsmouth? A. That is right.

Q. And if the Gas Department were an independent company, then the supervisor of customers' accounting and collecting for the Gas Department would have a more limited [R. p. 4054] sphere of activities than the present supervisor? A. That is true.

Q. He would have less to do than the present customers' accounting and collecting supervisor? A. He would have less accounts to supervise.

Q. And likewise the credit manager would have less to do? A. Yes.

J. V. Mitchell—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. And if the independent Gas Department were economically operated as an independent company, it might be very advisable to consolidate these two positions into one?

A. It might be.

Q. Mr. Mitchell, did you take part in any discussion with officers of your company in April or May of this year in which it was decided that Lybrand, Ross Bros. & Montgomery should be requested to make a study as to the interdepartmental allocation of expense? A. Yes, I did.

Q. Why was Lybrand requested to make that study?

A. Lybrand, Ross Bros. & Montgomery was requested to make that study because of this particular hearing.

Q. And but for these proceedings, the company would have continued with the old method of allocation between departments? [R. p. 4055] A. Very likely.

Q. What was it that made you feel it necessary to have Lybrand make this study? A. As I recall, certain exhibits that were submitted by the company in this case, and in the gas status case, were questioned in so far as separation of expenses between departments was concerned. In order that there might be placed in the record exhibits which would show a correct separation of such expenses and other charges between departments, it was decided that an independent certified public accounting firm should be employed to make the necessary study.

Q. Because you felt that your former system of allocation might be wrong? A. We did not feel that it was substantially wrong.

Q. Then why was the study made? A. Because of the attitude, as I recall, of the counsel for the Commission.

Q. You recommended the adoption of the method of allocation proposed by Mr. Taylor? A. Mr. Taylor recommended it.

Q. You likewise favored its adoption, did you not?

A. I think the adoption of it should be made, yes.

J. V. Mitchell—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. Why do you believe that? A. Because we feel now, after having had the benefit [R. p. 4056] of Mr. Taylor's organization having made the study, that his recommendation will bring about a separation of charges between departments that is as reasonably accurate as can be had.

Q. In other words, you think it is a better method of allocation than the method that was previously employed?

A. I think so, yes.

Q. And this new method of allocating expenses will not be any more costly; that is, it won't take up any more time of the accounting staff, than the old method, will it?

A. I think it will take up some little additional time, yes.

Q. Well, about how much time would you say; how much additional time would you say it would take the accountants of the company to break up and allocate the expense between the departments as proposed by Mr. Taylor?

A. I couldn't even guess.

Q. Would you say it would take the time of perhaps one or two or three more accountants? A. I don't know, because you just cannot see the places where it takes the additional time.

Q. Do you think that it might be necessary to increase your staff because of the work in connection with the allocation of expense as proposed by Mr. Taylor? [R. p. 4057]

A. Not directly, no.

Q. Indirectly, it might be necessary? A. To a very small extent.

Q. Do you have any plans for checking on the allocations from time to time by time studies or otherwise? A. Oh, yes.

Q. How often do you plan that? A. Mr. Taylor made recommendations that various checks be made from time to time. Some of the checks will be made on a three-months basis; some of the others will not be made in periods of less than a year.

J. V. Mitchell—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. Such studies will be made by the company? A. That is the present thought now.

* * * * *

[R. p. 4060] Q. I see. Now, of, say, about forty-five people that I now understand work on the allocation of expense, could you generally estimate how much time they spend—about one per cent of their time? A. I just don't know.

Q. You are thoroughly familiar with their work? A. Yes, but that is just one task out of many, and it cannot be separated from their other work.

Q. They do devote some time to it? A. Oh, they are bound to, because it is part of their work.

[R. p. 4061] Q. Has the adoption of the Taylor method of allocating expenses increased the amount of time of these employees? A. I think it has, some.

* * * * *

[R. p. 5035] Q. It is true, is it not, that the gas department is housed in a building that is owned by the Virginia Electric and Power Company in Norfolk? A. The main office of the gas department is housed in the [R. p. 5036] general office building located at Norfolk.

Q. Is any rent charged? A. There is no rent charged for the space used. There is a charge made against the department in connection with the costs of operating that building.

Q. Is that charge of cost of operation also made to the electric department? A. Yes, sir.

Q. How is that allocated? A. That is allocated on a general split of expense between departments of the company in the Norfolk division.

Q. On what basis is the charge made, the number of square feet occupied? A. No, it is not made on the basis of the square feet occupied by the gas department. It is a percentage basis which is determined from the net operating revenues of the various departments, compared to the total.

* * * * *

J. V. Mitchell—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

[R. p. 5044] Q. Are billing and accounting expenses a direct charge to the gas department and to the electric department, or are they based on an estimate? A. Some of them are based on an allocation between departments.

Q. The allocation is based on an estimate? A. Yes, sir. Let me qualify that if you will, please. It is based on an allocation of percentages determined from using the net operating net revenues of departments, as compared to the net operating revenues for the company.

Q. It is true, is it not, Mr. Mitchell, that the net operating revenues of each department have no relationship to the time devoted by persons who are billing and accounting, as [R. p. 5045] to gas customers and as to the time devoted for such work as to electric customers? A. Yes, sir.

* * * * *

J. V. MITCHELL

Redirect Examination

[R. p. 5049] Q. How is the expense of operating those jointly-used facilities, that you have just described, allocated as between Electric and Gas Departments? [R. p. 5050] A. The joint expenses are allocated between Electric and Gas Departments on the basis of net revenues.

Q. How about automobiles? A. In the case of pool automobiles, the expenses are allocated between the Electric and Gas Departments on the basis of the mileage used by each department.

Q. Now with that exception, what is the percentage that is applied or applicable to Gas? A. The percentage during the year 1939, I believe, that was applied to the Gas Department, was 12 percent.

Q. In other words, that was the ratio of net operating revenue in the Gas Department to the total? A. That is right.

J. V. Mitchell—Recross Examination

VIRGINIA GAS (Cont'd)

J. V. MITCHELL

Recross Examination

Q. Mr. Mitchell, how was that 12 percent arrived at?

A. The 12 percent was arrived at by comparing the net revenue of the Gas Department to the total net revenue of all departments in the Norfolk Division.

Q. When you speak of net revenue, do you mean the balance remaining after operating expenses are deducted from operating revenues? A. Yes, sir, I do.

Q. Are not expenses for customers' accounting and collecting, operating expenses? [R. p. 5051] A. Yes, sir.

Q. And sales promotion? A. Yes, sir.

Q. And administrative and general? A. Yes, sir.

Q. Then how can the net be determined before the amount of those items of operating expenses is determined?

A. I should have said that the ratios are determined at the beginning of the year, based on the figures for the preceding year.

Q. Well, when did this method of allocation start? A. This method of allocation has been in effect for several years. I am not certain as to the exact year when it started.

Q. What was the method employed before this method of allocation was employed? A. The method employed previously was based on the gross revenues.

Q. Why was that method discontinued? A. Because it was thought that by using the ratios based on the net revenues, a fairer distribution of expenses between departments would be obtained.

* * * * *

[R. p. 5063] Q. Your answers this morning, Mr. Mitchell, do not change the fact that the allocation of the items of expenses shown in Commission's Exhibit No. 3 as to customers' accounting and collecting, sales promotion, advertising, ad-

J. V. Mitchell—Recross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

ministrative and general expense as allocated between the Electric Department and Gas Department bear no relationship between the time devoted by the persons who carry on the activities that make up those expenses, is that not true?

A. It is true in regard to those expenses which are allocated on the basis of net.

Q. Why should it make any difference in regard to the expenses that are allocated on the gross basis? It still has no relationship to the time devoted by the persons employed to [R. p. 5064] carry on the duties that make up those expenses, is that true? A. It has no relation to the time devoted by the individuals, but I do believe that a gross allocation basis has a bearing on the distribution of expenses between the Departments.

Q. It has a bearing upon the way you have allocated the expenses? A. Yes, sir.

Q. But it has no bearing upon the fact that the expenses are not allocated upon a basis that represents the proportion of time devoted by persons in the various departments to the Gas activities as against the Electric activities, is that true? A. Not on the basis of the proportion of time, no.

Q. Is it not true that if an allocation were made on the basis of the time devoted by the persons who carry on those activities, it would be the most accurate allocation of the actual expenses that could be arrived at? A. I just cannot say, because it is an impossibility to determine the actual time which a man devotes on the Gas Department operations when his entire time is devoted to both the Electric and Gas.

Q. If his entire time is devoted to Electric and Gas, and all during the time that he is employed he is either working on activities for the Electric Department or the Gas Department, then would not a fair allocation be to divide up [R. p. 5065] the time and expenses equally between the Elec-

J. V. Mitchell—Recross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

tric Department and Gas Department? A. Well, he is either working on matters pertaining to the Electric Department or the Gas Department, or matters that are involved with both the Electric and Gas Departments.

Q. If he kept a time schedule showing the amount of time he was spending for the Electric Department and the amount of time he was devoting to the Gas Department, and his salary were allocated proportionately between the Electric Department and Gas Department in relation to such time, then aside from the amount of time that he was devoting to both departments, there would be a proper allocation, is that not right? A. I think it would still involve an element of estimating.

Q. But it would be a much more accurate estimate than an estimate based upon net revenues, would it not? A. I just can not say; I do not know.

Q. Well, it would come much closer to representing the actual expenses than an arbitrary allocation based upon net revenues, would it not? A. It would depend entirely on the estimate of the time which is concerned with working on both electric and gas matters at the same time.

* * * * *

[R. p. 5073] Q. And if, in a given year, there were no net operating revenues in the Gas Department, then none of Mr. Holtzclaw's or Mr. Throckmorton's salary would be allocated to the Gas [R. p. 5074] Department, is that correct? A. That is right.

Q. Do you believe that is a fair method of allocation? A. Not in a condition like that.

Q. Well, if the Gas Department's net operating revenues were a very small amount, it would likewise be unfair, would it not? A. Well, where you have a condition where the Department does not have any net after operating expenses, or a very small percentage after operating expenses, why, then it would not be a fair basis.

J. V. Mitchell—Recross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. Then we come back to the question that this basis in fact has no relationship to the actual expenses. A. It has no direct relationship to the allocation of expenses on the net basis.

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C. B. TAYLOR

Cross Examination

[R. p. 963] Q. If the charges in the past between departments of Virginia Electric and Power Company have been on cost, then isn't it true there would not be a necessity for you to come here today and propose any adjustments in these expenses? A. Well, a number of the adjustments that have been made here have not been made for the purpose of changing from some other basis to cost but have been made for the basis of setting up charges that have not been made at all in the past.

Q. Then to the extent to which they have not been made at all, there has not been a proper allocation of expenses at cost? A. To the extent that they have not been made at all, that is so.

* * * * *

[R. p. 964] Q. Were you the auditors of the company at about the end of 1933 when the company changed the method of allocating certain expenses from a gross basis to a net operating revenue basis? A. Yes, my firm were the auditors at that time.

Q. And you reviewed the audit? A. I am not absolutely sure whether I reviewed it or whether it was one of my partners at that time.

Q. Did you or your firm consult in regard to that change at the end of 1933 in the allocation of certain expenses of the company from a gross basis to a net operating revenue basis? A. I did not, myself.

Q. Did the firm? A. Not that I know of. I think it is most unlikely that the firm would have had that question to

C. B. Taylor—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

concern them because the firm was not interested at that time in an allocation of expenses between departments. They were looking solely at the income of the corporation as a whole.

Q. But in auditing the books of the company, are you not concerned with the income of the various departments?

A. To a certain extent, yes.

Q. Did you know the reason or do you know the reason for [R. p. 965] the change in 1933 in the method of allocating expenses of the company? A. I only know the reason as it was explained to me in the last week or so during this investigation which I have been making. I was told that the change was made because it was felt that the apportionment of expenses on a net revenue basis more accurately reflected the activities of each department than did the apportionment on a gross basis and, for that reason, it was changed.

Q. Do you agree with that reason? A. I cannot say that I agree with it or I do not agree with it because I think the only way in which you can determine what would be a fair method of apportionment would be to make an actual time study, say for a period of a month, in each of these departments to find out just how the services are rendered to the various departments.

Now, my own personal feeling is that if such a study were made, it possibly would result in something between a net revenue basis and a gross revenue basis. In other words, I think that the gross revenue basis perhaps falls a little unfairly on the transportation department and a little less heavily than it might on the electric department but that is, as I say, strictly surmise on my part.

* * * * *

[R. p. 3463] Q. Now, how did you arrive at the figure of three fourths or 75 percent as the basis for your weighting, or the basis for your statement, if it is correct, that because of the combination service only three fourths of the time

C. B. Taylor—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

that would otherwise be required is required in the performance of the services? A. That figure was arrived at by discussion with the comptroller of the company and the manager of the customers [R. p. 3464] accounting department and an inspection of the various records which are kept which show these combination services.

Q. In other words, it was based upon a review of the nature of the work performed by employees who perform this combination service? A. That is practically the only way you could arrive at it.

* * * * *

R. J. THROCKMORTON

Cross Examination

[R. p. 4121] Q. And if the amount of customers' billing and accounting expense to combination service customers amounts to \$19,400, or twice the \$9,700 shown on page 1 of Engineers' Exhibit 221, then how do you justify or reconcile that with your estimate of \$19,800 to the gas department, if independent? A. Because this figure of \$9,700 is the figure as set up in the Taylor report as the amount properly chargeable against the gas department.

Q. It would not be chargeable against the gas department? A. It is charged against the gas department.

Q. Well, how does that reconcile the two figures? A. Because you are going to need—what I mean is, you have your joint use of personnel, joint use of equipment, and all of those things come into this additional expense.

Q. My point is, Mr. Throckmorton, that if you have a certain number of people each of which do two things, such [R. p. 4122] as a meter reader reading electric and gas meters—A. Yes.

Q. (Continuing)—and a collector collecting electric and gas bills, and the cost of those people doing that amounts

R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

to \$19,400 for customers' billing and accounting; and then you tell those people that they do not have to collect electric bills or read electric meters, and so forth: Then, how do you explain that the expense for only doing one thing, instead of two, would increase \$400? A. Because they have to go to the same location to read the meter, anyway,—they have to go to the same location to collect from the individual customers, and they have to send out individual bills rather than the duplicate bills.

Q. And the cost of sending out the bills and so forth now, comes to \$19,400? A. It is a smaller operation.

Q. The combination electric and gas? A. I mean, it is a smaller operation as an independent gas company.

Q. My question, the one I was coming to, Mr. Throckmorton, is—you have those people going out and doing these things at a cost of \$9,700 charged to the gas department and \$9,700 charged to the electric department, or \$19,400 for the combination service, for customers' billing and accounting, and then you come along and—[R. p. 4123] A. (Interposing) I have not testified to that, because I do not think that is a fact.

Q. But if that is a fact—A. (Interposing) I cannot assume that.

Q. I am asking you to assume it on the basis of Mr. Mitchell's testimony, and if it is a fact—and at this point I might ask why it would not be a fact; do you know? A. No, I am not in a position to say.

Q. All right, then,—if it is a fact that it costs \$19,400 for customers' billing and accounting for electric and gas customers, and then you have a smaller operation and you tell these people that they do not have to read meters or do anything in regard to electric customers, just drop their work on that and do everything they were previously doing on the gas customers,—then, can you offer any reasonable explanation as to why the expense of that should increase \$400? A. This estimate of \$19,800 was made up by con-

R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

sultation with the department heads and with men who had long experience in public utility operations, and we have set up an organization that we think will give the same service that the customers are getting now, and we figure that the cost of customers' billing and accounting will be \$19,800.

Q. But you cannot reconcile that increase of expense of \$400 over the expense of \$19,400 to do the same thing for the electric and gas customers, can you? [R. p. 4124] A. I would have to make quite an analysis of it.

Q. What kind of an analysis could you make? A. I do not know.

Q. You mean that at present you do not know how you can reconcile the two figures? A. The only thing I can say is that we set up an organization to render the same type of service to customers in this accounting and collecting, and our estimate for the cost of doing that work is \$19,800 a year.

Q. My question, however, Mr. Throckmorton, was, could you reconcile the two figures presented before you? A. My answer is that I made no comparison and we set up an independent organization and that was the cost of operating an independent company.

Q. You said you made no comparison? A. No; we set up an organization with all of the experience that the department heads and the executives have had, and we set up an organization that we thought would provide the same type of service now being provided.

Q. And you did not compare that with the present expense or anything else,—you just drew from your experience and imagination? A. We did not use imagination, we had experience.

Q. You drew from your experience and made this estimate but did not make a comparison with the present expense, [R. p. 4125] is that right? A. The present expenses are prorated.

R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. I am aware of the fact that they are prorated, Mr. Throckmorton; I am asking you now if you made a comparison with the present expenses. A. We could not make a comparison of straight expense with prorated expense, very well.

Q. But the total of the prorated expenses to gas and electric departments should be more than the expense to the gas department, if independent, should it not?

The Witness: Repeat the question, please.

(Whereupon, the pending question was read by the reporter.)

The Witness: Not according to my estimate.

By Mr. Fischgrund:

Q. In other words, you think that it should cost the gas department more for customers' accounting and collecting than is expended for customers' accounting and collecting for both the gas and electric departments, for the combined service customers? A. I testified that our estimate of the cost of customers' billing and collecting under the independent set-up would be \$19,800.

Mr. Fischgrund: Read that question, please.

(Whereupon, the question was read by the reporter, as follows:)

[R. p. 4126] "Q. In other words, you think that it should cost the gas department more for customers' accounting and collecting than is expended for customers' accounting and collecting for both the gas and electric departments, for the combined service customers?"

The Witness: What did I say? Repeat my answer, please.

(Whereupon, the answer was read, as follows:)

"A. I testified that our estimate of the cost of customers' billing and collecting under the independent set-up would be \$19,800."

R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

By Mr. Fischgrund:

Q. Would you now answer the question, Mr. Throckmorton?

The Witness: Read the question again, now?

(Whereupon, the question was again read by the reporter.)

The Witness: I would not think, normally, that it would cost more, but under the set-up here, it appears to cost more.

* * * * *

[R. p. 4152] Q. You are a vice president of Virginia Electric & Power Company, in charge of the gas operations, are you not? A. In charge of the Norfolk division.

Q. Which embodies the gas department? A. Yes.

Q. Do you feel that you are entirely qualified for the presidency of the gas department if, an independent company? A. It is a very embarrassing question.

Q. Well, you know that you are. A. I am an operating vice president. I do not know much about the other part of it.

Q. You feel you are qualified to handle the operations of the gas department if it were an independent company, do you not? [R. p. 4153] A. Yes, I think I could.

* * * * *

[R. p. 4154] Q. You are familiar with the testimony, I believe, of Mr. Holtzclaw to the effect that if the gas department were an independent company, it would be advisable to retain Stone & Webster Service Corporation? A. Yes.

Q. Can you explain exactly why it would be necessary to retain that service corporation, that is, exactly what the service corporation would do other than that which is presently obtained by the gas department from outside sources? A. I would rather Mr. Holtzclaw explain that.

Q. I am asking for your opinion on that, your opinion in regard to what it would be necessary for them to do. A. I am not familiar enough with that to know.

R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. You are not familiar with what? A. With the question that you asked.

Q. What is there about the question I asked that you are not familiar with? A. To answer the question you asked. You asked me a question, and I said I am not familiar enough to answer it.

Q. You are familiar with the gas operations? A. Yes, sir.

Q. And you are familiar with what it would take to operate the gas department if an independent company? [R. p. 4155] A. Yes, sir.

Q. And you are familiar with the services presently obtained from Stone & Webster Engineering Corporation? A. Generally, yes.

Q. But you do not know what services, other than those presently obtained from Stone & Webster, it would be advisable for the gas department to have if an independent company? A. Well, it would be the same services we get now from Engineers Public Service.

Q. What are those services? A. Mr. Fischgrund, I am not in a position to give you the detail of what those services are. They service the whole property.

* * * * *

[R. p. 4174] Q. In other words, the executives of the company devote about 5 percent of their time and about 5 percent of their salaries is charged to the gas department. A. According to this report, yes.

Q. Do you believe that they do devote such a small amount of time to the gas department? A. I do, yes.

* * * * *

[R. p. 4175] Q. But much of the time that they do devote to the gas department consists of keeping abreast of the gas operations? A. Checking the operations and seeing how the property is going; discussing possible expansions. It does not take very long.

* * * * *

R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. How many sales engineers does the company have in Norfolk? A. They have two that devote their entire time to gas, as outside salesmen. Another is outside part of the time and does a lot of clerical work in the office.

Q. Two that devote their entire time to gas? [R. p 4176] A. Yes, sir.

Q. Are they commercial or industrial sales engineers? A. Both.

* * * * *

[R. p. 4179] Q. You observe, Mr. Throckmorton, on the second page of Engineers' Exhibit No. 223, that it is estimated that the advertising expense— A. (Interposing) What page is that?

Q. The second page.

(Continuing)—that advertising expense would increase \$2,500 a year if the gas department were an independent company, according to that estimate? A. Yes.

[R. p. 4180] Q. You observe that? A. I do.

Q. Do you know the reason for that, or why, in your opinion, it was necessary for that increase in expense? A. Well, I think they would have to do quite a bit of good-will advertising and additional merchandise advertising and probably could not get as low a rate as they are getting now in the papers, and \$300 a month seemed to us to be a rather low figure for advertising.

Q. In other words, you think that the entire amount of the company's advertising, if it was an independent company, would be about \$300 a month? A. Of an independent gas company?

Q. Yes. A. Well, I think it would be at least that.

Q. That would be for general sales promotion and also for the sale of appliances? A. Yes.

Q. Do you know the amount charged to the gas department now for a similar type of advertising? A. No, I do not have those figures.

R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. Do you know how much it was during 1940? A. No, I do not.

Q. It was more than \$1,000 or \$1,100, to your knowledge, was it not? [R. p. 4181] A. I could get that information for you, but I could not say, offhand.

Q. You believe that there would be an increase of \$2,500 a year in advertising if the gas department were an independent company? A. Yes, as shown in this statement.

Q. That is on the basis of \$1,100 now charged for advertising, subtracting from \$3,600 for advertising if the gas department were independent? A. That is based on the comparison with the Taylor report.

Q. Does the \$1,100 of advertising include advertising for merchandising and jobbing charged to the gas department? A. That footnote reads that it is adjusted to reflect—

Q. (Interposing) My question was whether or not it includes advertising for merchandising and jobbing. A. It is on a prorated basis.

Q. Does it include it? A. It includes all advertising chargeable to the gas department.

Q. Do you believe that under the present operations the normal advertising expense chargeable to the gas department would not amount to more than \$1,100 a year? A. About that, yes.

Q. And how do you reconcile that with page 45 of [R. p. 4182] Engineers' Exhibit 202, which is the Taylor report, which shows that during 1940 advertising charged to merchandising and jobbing, and applicable to the gas department, amounts to \$2,565? A. That is based on the Taylor allocation of the gas department's proportion of the total advertising cost.

Q. There was some advertising expenses charged to the gas department in addition to the \$2,565 charged to the gas department's merchandising and jobbing operations during 1940, was there not? A. I am not familiar with that, Mr. Fischgrund.

R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. Well, are you familiar enough with it to know that in your opinion it would require \$300 a month advertising for an independent gas company? A. A minimum of that amount, yes.

Q. And you are familiar with it enough to know that there was \$2,500 of advertising for the gas department last year? A. Well, I see that from the Taylor report, yes.

Q. And you also know, do you not, that there was about \$1,100 in advertising charged to the gas department, itself, and not to merchandising and jobbing operations, during 1940? A. Well, this adjusted figure—is that what you are talking about?

[R. p. 4183] Q. I am using that as the basis, yes. A. According to that exhibit, yes.

Q. And the total of those two figures amounts to about \$3,665? A. Yes.

Q. That would be about how much, in your opinion, the gas department paid in advertising last year, would it not? A. Well, I think we could find that out exactly, just what they did pay.

Q. But it is still your opinion that there would be an increased expense for advertising if the gas department were independent, over the amount paid now? A. I did not say an increased expense, I said our estimate was that there would be an expense of at least \$300 a month for advertising as an independent company.

Q. And what is the reason for spending that much if only \$1,100 is now spent for advertising during a given year? A. Well, we would have to do more advertising than we are doing now.

Q. Why? A. Well, they would have a lot of good-will advertising to do.

Q. That is, until they became established, they would? A. I think so.

R. J. Throckmorton—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

Q. But after they were established as an independent [R. p. 4184] gas company, then what? A. It would be entirely a matter of policy with them.

Q. They may very well return to the same amount of advertising expense as charged to the gas department now? A. I do not think it would get as low as it is now.

Q. Why not? A. They could not carry on as they are now.

Q. In other words, whatever increase there may be because of setting up an independent gas company, in the form of increased expense in advertising, it would be in the form of an non-recurring expense? A. No, I did not say that.

Q. Is that not true? A. I do not think so.

Q. Why not? A. You mean, any increase of \$2,500 is a non-recurring expense,—is that what you asked me?

Q. That is right. A. I would not say it is a non-recurring expense; I think it would go on—certainly a large portion of it.

* * * * *

[R. p. 5133] Q. Who is directly in charge of the gas operations? A. R. C. Brooks.

Q. What is his position? A. He is manager of the department.

Q. Is he directly responsible to you? A. Yes, sir.

Q. He devotes all his time to gas operations? A. His entire time.

Q. And he has full authority over the gas operations? A. Yes.

* * * * *

H. V. FABER

Cross Examination

[R. p. 4375] Q. If the gas department were an independent company why couldn't they rent that space to the electric company? [R. p. 4376] A. Well, I would say that that

H. V. Faber—Cross Examination (Cont'd)

VIRGINIA GAS (Cont'd)

would be a managerial decision, and if I had anything to do with it I don't believe you would keep it there.

Q. That is because you wouldn't want your competitor in the same building. A. That is because if two interests get together, why, I don't believe they get along very well. We have a common interest now and it would be separate interests under this proposed gas company being a separate company. There wouldn't be anything in common.

Q. Would you say that if the gas department were independent that they would have conflicting interests with the electric operations? A. I think the gas, another gas company would try to do its best job, and they may want to do things differently than they are being done now.

Q. You wouldn't say that the interests of a gas utility and an electric utility though would run cross current, would you? A. I believe they would if they were separate.

* * * * *

VIRGINIA AND EL PASO TRANSPORTATION

T. NORMAN JONES

Direct Examination

[R. p. 510] Q. Will you now contrast the difference in the effect which was produced in your thinking on this subject, and in the [R. p. 511] light of your knowledge of the company's operations, by pointing out the difference in the result if the allocations were made on the former basis, that is the gross operating revenue basis, as compared with the net operating revenue basis? A. Applying to the year 1933 the method of allocating general expense which was applied during the year 1932, on the gross operating revenue basis, the percentage allocated to the Street Railway Department would have been 17 per cent; the percentage allocated to the Bus Department would have been 10 per cent; the percentage allocated to the Electric Department would have

T. Norman Jones—Direct Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

been 66 per cent and the percentage allocated to the Gas Department would have been 7 per cent.

Applying the net operating revenue basis for the year 1933, the percentages were as follows:

11 per cent allocated to Street Railway; 6 per cent allocated to Bus; 77 per cent allocated to the Electric Department; and 6 per cent allocated to the Gas Department; the total percentage applicable to the Transportation Department, Railway and Bus combined, on the gross operating revenue basis being 27 per cent as compared with 17 per cent on the net operating revenue basis.

* * * * *

T. NORMAN JONES

Cross Examination

[R. p. 565] Q. Is there any reason why, if the street railway were owned by a separate company, that the poles could not be used by both the electric department in connection with the street railway operations under the same sort of arrangement that the company has with the telephone and telegraph companies? A. I think undoubtedly a joint use arrangement could be worked out.

* * * * *

[R. p. 568] Q. Well, any company that would have been operating a railway system in Petersburg and wanted to change to bus would have been required to continue to operate busses? A. I think that is true.

Q. So that requirement was not peculiar to the company being engaged in the electric business? A. Well, there is no relationship between the serving of a customer with electricity for light and power and hauling a passenger on a car from that standpoint . . .

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T. Norman Jones—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

[R. p. 600] Q. Would you say that in your opinion the operating problems of the transportation department are so separate and distinct from those of the company's operations otherwise that the transportation department can most economically and efficiently operate under a separate head?

A. I think that the problems are so different that it is better to have a man devote his time to the study of transportation problems, and let someone else devote their time to the study of the electric problems, within the limits of the actual operations.

* * * * *

[R. p. 603] Q. Do you know how much property was found to be in the electric utility plant account and used solely by the railway? [R. p. 604] A. I can't answer that, I don't know.

Q. You mean that the State Commission found that there was a substantial amount of property that the company carried in its electric utility property account and it permitted it to remain in its electric utility property account, although it was used solely for railway? A. That it found that there was an amount, whatever the figure was—I don't remember, in the electric plant account that was used in connection with the railway operations.

* * * * *

J. G. HOLTZCLAW

Direct Examination

[R. p. 760] . . . in the year 1940, 879,045,631 kwh were generated in all of the company's power stations, or purchased from outside sources. Of this amount, 34,162,978 kwh were delivered to the transportation department for the operation of street cars and for miscellaneous uses.

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J. G. Holtzclaw—Cross Examination

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

J. G. HOLTZCLAW

Cross Examination

[R. p. 1158] Q. Has there been enough, in your opinion, accrued each year for the past ten years to the retirement reserve from the Railway Department to take care of the retirements, write-downs and depreciation of railway property? A. We have never separated our retirement reserve among the departments.

Q. However, assuming that an aggregate amount will have been accrued to retirement reserve to cover the electric and gas property depreciation, is it your opinion that the remainder applicable to the transportation department would have been sufficient as an accrual to retirement reserve to cover the amount of the retirements, write-downs, or would it have been sufficient as an accrual in your opinion? A. The property has been written down to approximately \$10,000,000. On the basis of depreciation as being accrued at the present time, it can be retired in 15 years, and the property is in such condition as to last considerably longer than that.

Q. However, looking to the past ten years, as to which you were making adjustments, to which you testified in your direct testimony, is it your opinion that if you made a segregation of the accrual to the retirement reserve, so as to show a sufficient accrual to cover the electric and the gas property, is it your opinion that the remainder would constitute a sufficient accrual for depreciation of the railway property and the bus property?

[R. p. 1159] The Witness: Will you read the question.

(Whereupon the pending question, as above recorded, was read by the reporter.)

The Witness: In my opinion, the charge-offs to the Railway Department in the past ten years to the depreciation account represent all the accrued depreciation in it and

J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

it permitted it to run along for 15 years as depreciation as earned after taxes were charged off.

Q. It is your opinion, is it not, that if there were such a segregation as I suggested, the amount that would be shown as the railway accrual to retirement reserve, would not, in your opinion, constitute a sufficient accrual to the retirement reserve in the light of the retirements and write-downs and depreciation of railway and bus properties?

A. The answer to that involves an expression of opinion as to what is an ample retirement reserve or depreciation reserve for electric and gas, and that never has been decided. We haven't allocated even the retirement reserve which the company had as of January 1, 1937, between the departments.

Q. If there had been a segregation in the accruals to retirement reserve, is it your opinion that there would be any income after depreciation for the Railway Department over the past ten years?

The Witness: Read that please.

[R. p. 1160] (Whereupon the pending question, as above recorded was read by the reporter.)

The Witness: I don't believe I understand that question, Mr. Fischgrund.

Q. You testified, that making the adjustments that Mr. Taylor proposed for 1940, over the past ten years, there would be \$5,227,634 available for depreciation? A. Yes.

Q. And you also testified that the amount of the retirements and write-downs during that period amounted to some \$11,000,000? A. That is right.

Q. You also testified that the amount of the retirements alone were some \$600,000 in excess of the \$5,000,000 figure which you stated was available for depreciation? A. Yes.

J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Q. In light of that, would you say that, if there had been a segregation of the amount of the accrual to the retirement reserve, a segregation, and that there would be a separate amount allocated to the Railway Department, would it be your opinion that there would still, after such segregation, be any net income after depreciation for the Railway Department? A. Not in the last ten years, no, sir. Very little if any.

[R. p. 1161] Mr. Moore: You mean including the write-offs, is that what you mean?

The Witness: You are including the write-offs in that? By Mr. Fischgrund:

Q. Wouldn't that also be true even if you didn't include the write-offs? A. No, sir.

Q. It would not? A. I don't think so. I haven't got that figure, but I don't think that is true. Including \$5,-800,000 of write-offs it is true.

Q. How does the inclusion of the write-offs change the amount that you would set up as depreciation charges for the Railway Department, if you segregate the depreciation of the Company during the past ten years? A. Well, you are asking a question referring to the last ten years, as I understood it?

Q. Yes. A. And if we had allocated to the various departments over the last ten years on the basis of some percentage ratio, it would not have been sufficient to have charged off all the property that has been charged up, plus the write-downs in the last ten years.

Q. I believe the question, Mr. Holtzclaw, was addressed to whether or not there would be any net income after depreciation [R. p. 1162] if you had segregated the depreciation of the company by departments during the past ten years? A. I am not prepared to answer that question without further work on it.

J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Q. Further what? A. Without further work on the subject.

Q. Thank you. Do you know how much of \$5,227,634, that you testified would be the adjusted earnings of the Railway Department over the past ten years before depreciation, was paid out in dividends? A. I do not.

Q. Do you know of any amount that was paid out in dividends? A. Not out of Railway earnings. Dividends were paid out of the general funds of the Company.

Q. You don't know whether or not any of it was or was not paid out in dividends? A. Any net left in the Railway operation went into the general funds of the Company and dividends were paid out of the general funds.

Q. In arriving at the adjusted net operating revenues of the Railway Department over the past ten years, you adjusted the expenses of the Railway Department, I believe, by increasing such expenses in the amount of \$966,715? A. That is right, sir.

[R. p. 1163] Q. And those expenses were borne by the Electric and the Gas Departments, were they not, over the past ten years? A. Presumably so, yes.

Q. Why do you say, "presumably," Mr. Holtzclaw? Is there a doubt that if they were not charged to the Transportation Department, they must have been expenses of the Electric and Gas Department? A. Joint use of buildings does not represent an expense borne by the Electric Department, as an out-of-pocket expense. The way Mr. Taylor has figured, he has charged the Railway as a rental on the joint use of these facilities, but it has not been an out-of-pocket expense for the Electric Department, except in so far as carrying charges on the building were concerned. That is the reason I say "presumably."

Q. In so far as Mr. Taylor has made the allocation of such expenses, however they were borne by the Electric and Gas Departments? A. That is right.

J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Q. They were considered as an expense of the Electric and Gas Departments in fixing of electric and gas rates over the past ten years, were they not?

The Witness: Read that, will you please.

(Whereupon the pending question, as above recorded, was read by the reporter.)

The Witness: In so far as they were out of pocket expenses, [R. p. 1164] yes.

Q. But in so far as they were allocated to the Electric and Gas Departments on the books of the Company, rather than the Transportation Department— A. (Interposing) As an operating expense. There have never been rent of buildings or rent of poles or other facilities, rent of manholes, charged on the books.

The Electric Department has carried the charges in the nature of depreciation and taxes, but in so far as they represented out-of-pocket expenses, they have been set up on the expenses of the other two departments undoubtedly.

Q. Then, in so far as they have not been allocated to the Transportation Department, they have been charged as expenses to the Electric and Gas Departments? A. That is right, with the exception of some of the allocations which do not represent out-of-pocket expenses of the Electric Department, which Mr. Taylor has allocated to the Railway.

I refer to the rent of buildings—of space in buildings—the joint use of poles; the joint use of manholes, which, now set up in Railway operating expenses and credited back to Electric operating expenses, have never appeared anywhere in expenses.

According to Mr. Taylor's allocation, now they go to the [R. p. 1165] Railway Department and will be a credit to Electric.

J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Q. Weren't those expenses shown as an expense of one or another of the departments during the past ten years?

A. No, sir, they have not.

Q. They were shown only as Company expenses? A. Not shown as any expenses. There has been nothing set up on their books for the joint use of poles or the joint use of office buildings, or the joint use of manholes.

The Company made the investment in poles and office buildings and manholes, and naturally carrying charges on those various items, but nothing has been set up in operating expenses except in so far as the maintenance and operation expenses of those facilities are concerned.

Q. Do you know what property accounts those items you refer to were carried—that is, poles and manholes?

A. I think Mr. Taylor went quite thoroughly into that and his testimony is far better than mine. By and large it is an Electric plant account—those items, office buildings, manholes, some poles in the Electric and some poles in the Railway plant account as testified by Mr. Taylor.

Q. They were considered without recognition of the Railway Department's use of such facilities in fixing electric and gas rates, were they not? A. I didn't understand. Will you read that please.

(Whereupon the pending question, as above recorded, was [R. p. 1166] read by the reporter.)

The Witness: Would you mind asking that again, Mr. Fischgrund. I didn't understand it. "Without recognition."

Q. Well, if the property was carried in the Electric property account and no charge was made or allocation made to any other department other than the Electric Department for the use of such facilities, then in considering the electric rates, any regulatory body necessarily looked at all that property as solely electric property and in looking at the statement and the income statement of the Electric

J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Department, looked at all of the expense in connection with such facilities as expense incident to the Electric Department, is that not true? A. All of those items have been in the electric rate base and there has been no charge made against Transportation Department for their use. To that extent the Electric Department has benefited.

Mr. Lester: Have the consumers benefited?

The Witness: What?

Mr. Lester: Have the consumers been benefited?

The Witness: Electric or Railway?

Mr. Lester: Electric.

The Witness: No they haven't been benefited, nor have they been seriously injured.

Mr. Lester: They have been injured, haven't they?

[R. p. 1167] The Witness: If the allocation suggested by Mr. Taylor is adopted as the way accounts must be kept in the future, I think the Electric net will be larger in proportion to its rate base and the Railway net will be smaller in proportion to its rate base.

To that extent the Electric rate payers may benefit in the future and the Railway rate payers may suffer in the future.

Q. Haven't the Electric rate payers been injured in the past? A. That depends upon whether or not the Company has earned a fair return on its investment.

* * * * *

[R. p. 1242] Q. As a matter of fact, aside from Mr. Jones, the executives at present devote practically none of their time to the Transportation Department? A. A small percentage of their time.

* * * * *

[R. p. 1244] . . . if the Transportation Department were disposed of, the rapid expansion and growth of the Electric

J. G. Holtzclaw—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Department will assure a full day's work for all executives in the company.

* * * * *

[R. p. 1248] Q. The reason that you testified that there would be an increase in the electric expenses if the Transportation Department were disposed of is that the executives at present are overworked and they have to work on Sundays and longer than normal hours? A. No. The 16 executives work very hard and sometimes long hours. My judgment is that if the Transportation Department were disposed of not one of them can be dispensed with.

Q. And it is your opinion that they would have to work just as hard? A. I think so. The growth in electric will take up all the slack.

* * * * *

[R. p. 1263] Q. Do you have sufficient demand for space by the electric and gas departments so that you could use it if the transportation department were sold? A. Every office is full, and many of them overflowing.

* * * * *

[R. p. 1265] Q. If you didn't rent the space occupied in the building in Richmond to the transportation department, upon its being sold, do you believe that the electric and gas departments would find reason that would require them to use that space in their normal growth and expansion? A. There is no doubt about it, we could use it right now.

* * * * *

[R. p. 1282] Q. The question is not whether it is right or wrong, I am making the assumption and asking whether or not in your opinion it is not true that if the railway department were sold, and the railway operations continued, that the electric department would receive, for rental from its poles, an amount [R. p. 1283] that would be equal at least to the \$3,927.50 allocated to the transportation department?

J. G. Holtzclaw, Direct—H. C. Leonard, Cross (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

A. Based on your assumption—which I think is incorrect—there would be some change in that figure there, but probably not the same figure.

Q. The same thing would be true as to the rental of manholes and conduits, would it not? A. Based upon the same assumption.

* * * * *

J. G. HOLTZCLAW

Redirect Examination

[R. p. 2183] I have been informed by officials of the Gulf States Utilities Company that the situation at Beaumont, Texas, at the time of the sale of the transportation properties of Eastern Texas Electric Company, was as follows:

During the year 1937 in which the transportation properties were sold, the average number of employees in the Beaumont area was 302, of which only 89 joint-use employees working for both the electric and transportation departments were given transportation passes. The average number of rides per month by these 89 employees having passes was 3,275. The average monthly riding per employee was 37 rides at 6 cents per ride, or a total value of \$2.22 per month per employee having passes.

It appears that neither in Beaumont or Baton Rouge was any direct increase in compensation made to employees having such free transportation by reason of the withdrawal of such passes. . . .

* * * * *

H. C. LEONARD

Cross Examination

[R. p. 1586] Q. Mr. Leonard, does Baton Rouge Bus Company supply any free bus service to employees of Gulf

H. C. Leonard—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

States Utilities Company? A. No, it does not except in the case of joint employees.

Q. It supplies free bus service to its own employees, [R. p. 1587] that is, employees of Baton Rouge Bus Company, Inc.? A. Yes.

Q. Was free bus service supplied to employees of the Baton Rouge Electric Company before 1938? A. Yes, it was.

Q. In 1938, the electric properties of Baton Rouge Electric Company were transferred to Gulf States Utilities Company, and the transportation properties to Baton Rouge Bus Company, Inc.? A. That is correct.

Q. Was any change made in the salaries of employees of the Baton Rouge Electric Company who ceased to obtain the free transportation service after 1938 because of the—
A. (Interposing) No general increase.

* * * * *

L. F. YETMAN

Direct Examination

[R. p. 2936) Q. Mr. Yetman, it appears from the statement marked "Engineers Exhibit 176" that the amount of \$124,822.23 was set aside by the El Paso Electric Company system during the year 1940 for depreciation of the transportation and bridge department excluding busses. Will you give us the breakdown of this amount? A. Of the amount of \$124,822.23 assigned to the transportation department, including Juarez, for accrued depreciation for the year 1940, \$85,722.23 is applicable to the street railway property, including bridge property, of El Paso Electric Company (Texas), \$15,000 for street railway and bridge property of El Paso and Juarez Traction Company, and \$24,100 to the bus property of El Paso Electric Company (Texas). You will understand that there is no actual segre-

L. F. Yetman—Direct Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

gation of the accrual between departments as yet on the books of El Paso Electric Company (Texas).

* * * * *

L. F. YETMAN

Cross Examination

[R. p. 3058] Q. The charge for DC energy in the interdepartmental charges, which you testified to, is 1.1 cents per kilowatt hour and is based on the company's large wholesale power rate? A. Yes, I believe that is correct.

Q. The power rate for large wholesale sales includes the profit to the company? A. There is some element of profit there, I would say.

Q. And also the charge for AC energy, as made to the transportation department in the interdepartmental allocation of costs, which you proposed and testified to yesterday, is based on the rate for that class of service, is that not true? A. The regular prescribed rate, yes, sir.

Q. That rate also includes the profit of the electric department? A. I would say there is some element of profit, yes,

* * * * *

[R. p. 3073] Q. Now, are all the poles used jointly by the transportation and the electric departments, carried in the electric utility property account? A. No, I think there are some jointly used poles that are in the railway plant account.

* * * * *

[R. p. 3074] Q. If the company sold its transportation department, is there any reason why there could not be a joint use agreement for the purchaser's using the electric poles of the company and for the electric department's using the railway poles on a similar basis to your agreement with the telephone [R. p. 3075] company? A. I assume that they probably could be worked out.

* * * * *

L. F. Yetman—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

[R. p. 3094] Q. Do you believe that if the transportation department were disposed of and the company retained practically all of the joint employees that the company would be efficiently operated? A. Yes, they would, in my opinion, have to retain them to continue on an efficient basis.

Q. And you believe that after the transportation department were disposed of and practically all the joint employees were retained that the company would be efficiently operated? A. Yes, I would say so, if that personnel is retained.

Q. And you believe that all the time of these joint employees would not be required in the operation of the electric system, however, do you? A. Yes, I believe they could be advantageously used in the operations of the electric system.

Q. You don't contemplate any expansion of the electric system during the next few years to require the increased time and personnel, do you? A. Oh, yes, yes. As we add new customers that natural expansion would require the use of them, certainly.

Q. In other words, you think the electric system would [R. p. 3095] be efficiently operated with all of the joint employees after the transportation system were disposed of because the expansion of the electric system would take up the time of joint employees, which time they now devote to transportation matters? A. That would be correct, yes.

* * * * *

R. S. NELSON

Cross Examination

[R. p. 3143] Q. The electric system does not in any real sense depend on the railway electric load for the economical and a successful operation of the electric system? A. No, sir.

R. S. Nelson—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Q. In fact, the electric system does not depend on the railway demand in any real sense whatsoever? A. Well, the railway load is a very small item in the total load of the system.

Q. So that today, with the development of the electric system and the replacement of the railway transportation with autos and buses, the railway load is an insignificant portion of the total electric load? A. Yes, sir.

* * * * *

[R. p. 3177] Q. And as a practical matter, if the electric department assumed the burden of the expense of the pension to the transportation employees, the net income of the transportation department, as shown in the reallocated income statement would be increased by the amount of such pension payments, is that not true? A. Yes, sir; if the electric department assumed the expense.

Q. And you have assumed that the electric department would assume that expense on a sale of the transportation department? A. In my judgment it would be obliged to.

Q. You have also testified, have you not, that the net income and the net operating revenues of the transportation department would have a vital effect on the price that the company could obtain for the transportation property? A. I am sure that would be a very important consideration.

* * * * *

[R. p. 3188] Q. If the company discontinued giving free passes to its employees, the operating revenues of the transportation department would increase, would they not? A. To some extent I believe they would.

Q. Likewise the net operating income would increase? A. Yes, sir.

* * * * *

[R. p. 3211] Q. Do you have one man in the company who is directly in charge of the transportation operations of the company? A. Yes, sir.

R. S. Nelson—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

Q. He does not devote any time to electric operations?

A. No, sir.

Q. Is he the man that the company brought into their employ a short time ago to handle the transportation operation? A. He is the man whom we transferred from the Virginia Electric & Power Company some three years ago, I believe, to be general superintendent of the Mesilla Valley Electric Company. He is an engineer and had some transportation training and experience in the Virginia property before coming to the Mesilla Valley Electric Company.

Mr. Lester: He is the man referred to in Mr. Will's testimony.

The Witness: Referred to as what?

Mr. Lester: Referred to as the new man brought in to have charge of the transportation operations.

Mr. Moore: Mr. Davis.

The Witness: Yes, sir. In Mr. Will's reference, I am sure that Mr. Will meant, in his expression "brought in", that [P. p. 3212] I moved him from Mesilla Valley Electric Company in Las Cruces to El Paso last fall to take charge of the transportation operations.

Mr. Lester: Prior to that time, Mr. Will had been general superintendent not only for the electric operations but also for the transportation operations?

The Witness: For a certain period of time.

Mr. Moore: The man was Mr. Davis, wasn't it?

The Witness: John A. Davis, Jr.

By Mr. Fischgrund:

Q. Mr. Davis more or less runs the whole transportation system at present? A. He runs the whole transportation division under my supervision.

Q. He has nothing to do with the electric system?

A. Nothing whatever.

* * * * *

R. S. Nelson—Cross Examination (Cont'd)

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

[R. p. 3213] Q. From an operating standpoint, there is not any substantial relationship between transporting by busses and the transportation and distribution of electric energy, is there? A. Not in the way that you mean, I am sure, but in my opinion I think there is a substantial advantage in the fact that we operate both, organization-wise.

Q. Do you mean by reason of the bigness of the company in having both operations? A. I mean, by reason of the security of the employee, the security we are able to offer to the employee.

Q. If the company were operating an oil business, it would be able to offer quite a bit of assurance of employment to all employees of a substantial nature because of the security of the electric business, is not that true? A. Do you mean if the company were operating an oil [R. p. 3214] business and the electric and transportation business?

Q. If the company were operating an oil business and an electric business, you would have the same relationship that you spoke of that existed between the bus business and the electric business? A. To some extent, I think you might well have it, yes, sir.

* * * * *

[R. p. 3217] Mr. Lester: Is the matter of public relations the only common factor between the two businesses?

The Witness: Well, I do not know as I would call it a common vital factor.

Mr. Lester: It would have to be considered as a vital factor?

The Witness: I would consider it an important factor and I would consider the advantages to the organization as an extremely important factor.

Mr. Lester: Is there any other important factor?

The Witness: No, except to make some money out of each one of them.

* * * * *

C. B. Taylor—Cross Examination

VIRGINIA AND EL PASO TRANSPORTATION (Cont'd)

C. B. TAYLOR

Cross Examination

[R. p. 3460] Q. Well, if I understood you clearly, you stated that in the case of employees for the electric and gas departments you determined that perhaps less time was required to handle the combination service? A. That is so.

Q. But you did not make any such determination or study in respect to employees who render services for the transportation and electric departments? A. Well, you do not have the same combination of services between electric and transportation as you would between electric [R. p. 3461] and gas. You do not have any combination billing, for instance, between electric and transportation. You would not have any meter readings so far as transportation is concerned. So, you are not faced with the same problems in dealing with the combination of electric and transportation as you are in dealing with electric and gas.

Q. In other words, you thought the type of the operation was so distinct that consideration should not be given to the weighting of salaries of joint employees of the electric and transportation departments; is that a correct understanding? A. That is perfectly true.

* * * * *

EXHIBITS

Commission Exhibit 65

[R. p. 6061] EL PASO ELECTRIC COMPANY

EL PASO, TEXAS

August 8, 1941

AIR MAIL

Mr. Wm. E. Tucker
c-o Carlton Hotel
Washington, D. C.

Dear Mr. Tucker:

In connection with the information regarding the time and circumstances under which this company discontinued the practice of affording reduced rates to employees for electric service, which information is needed to complete my testimony before the Securities and Exchange Commission, given upon cross examination appearing on Pages 3189 and 3190 of transcript, I have been glad to investigate this subject since my return to El Paso and submit this letter of explanation to become Commission's Exhibit No. 65.

I find that for many years prior to October 18, 1929, the residential electric rate of the company was a room type rate which resulted in the average customer paying a charge of 10¢ per kilowatt-hour for the first 30 kilowatt-hours used per month, 6¢ per kilowatt-hour for the next 30 kilowatt-hours used per month, and 4¢ per kilowatt-hour for the excess, whereas, the employee rate for residential electric service was the standard rate with a special discount applied to bring the rate down to a flat charge of 7¢ per kilowatt-hour used per month.

As of October 18, 1929, certain changes and reductions were made in the residential service rates to customers, and a memorandum of instructions dated October 15, 1929 was issued by the management to the Accounting Department, which read as follows:

Commission Exhibit 65 (Cont'd)

EXHIBITS (Cont'd)

"EMPLOYEES' HOME LIGHTING RATE
FOR LIGHT AND POWER

"Effective on all meters read after midnight of October 18, 1929, the rate per kilowatt-hour for residence lighting and incidental household power appliances charged employees of this company will be 6¢ net per KWH instead of 7¢."

We find from our records that from October 18, 1929 to February 10, 1934, the net rate of 6¢ per kilowatt-hour was charged employees except in the case of those whose use of electricity had increased to the point where the standard residential [R. p. 6062] rate of the company resulted in a lower cost to them than an average of 6¢ per kilowatt-hour per month, in which case they were changed over to the standard rate. As of February 10, 1934, the employee rate of 6¢ net per kilowatt-hour was made not available to new employees and the gradual changing over of employees' accounts from the special employee rate to whatever new or reduced standard rate became more advantageous, continued to March 1, 1936, at which time the last change-over was accomplished and the special employee rate abolished.

It will be apparent from the foregoing that the policy of the company through the years from 1929 to 1936 was to continue the special employee rate adopted on October 18, 1929, without any further reductions or revisions, and that the elimination of this special rate was a gradual process which did not result in increasing any employee's charge for electricity to any appreciable extent or in such a way as would have been the case if the privilege of reduced rates had been extended for many years on some percentage basis and then suddenly withdrawn. We find no record of any increased compensation having been paid to any employees as the result of discontinuing the practice of offering a special reduced employee rate for electricity. Obviously, no such compensation would have been considered

Commission Exhibit 65 (Cont'd)

EXHIBITS (Cont'd)

in view of the manner in which this special privilege was discontinued as above explained.

Yours very truly,

(Sgd.) R. S. NELSON

R. S. NELSON,
President.

Engineers Exhibit 229

EXHIBITS (Cont'd)

[R. p. 8073] Engineers Public Service Company, Inc.

Form U-13-1

EXHIBIT F

TABULATION OF CERTAIN SPECIFIC SERVICES RENDERED

Financial Assistance

Follows the financial condition of the companies and arranges for necessary financing and refinancing at most advantageous times possible and on the most favorable bases possible, including negotiations for bank loans and sales of securities.

Giving advice and assistance in the drafting of mortgages or supplemental indentures to insure for the companies equitable provisions, such as reasonable covenants, workable release provisions, and fair redemption and sinking fund requirements, and other papers in connection with issues of securities.

Compiles financial statements, Federal and State commission applications for authority to issue and sell securities, stock exchange listing applications, statistical comparisons, preparation of registration statements and prospectuses, applications for qualification of securities in various states under so-called Blue Sky Laws, and other data in connection with the sale of securities.

Relations with Stockholders and Publicity

Preparation and distribution to stockholders and to others of annual and monthly reports, financial and statistical data.

Answering requests for information from stockholders and others interested.

Plans, arranges and disseminates information through articles, news items, advertisements in newspapers or other periodicals, and circulars.

Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

Treasury

Obtains loans and arranges renewals of loans, also placing of equipment notes.

Payment of funds to Trustees to meet semi-annual interest on bonds, debentures and notes together with the sinking fund requirements thereon.

Payment of funds to Dividend Paying Agents for quarterly dividends on preferred and common stocks.

Handling, in the first instance, the receipt and disbursement on the proceeds from sale of securities.

Reacquiring of bonds from public to satisfy sinking funds and deposit of same with Trustees.

Validation of mutilated coupons on bonds and advising New York Stock Exchange, when securities are listed.

Signing temporary and definitive bonds issued by companies.

Following cash requirements of companies in order to arrange for bank loans at proper time and compilation of data in connection therewith for the officers of the companies and for the banks interested.

[R. p. 8074] The maintenance of records for the intelligent and adequate handling of the funds received, disbursed or arranged for through New York depositaries and the carrying on of correspondence arising from or pertaining to the various transactions. The records include notes payable, history of outstanding securities, sinking and escrow operations, weekly balances of cash and monthly estimates of cash requirements.

Representing the companies in handling of unusual transactions with trustees, transfer agents, paying agents, registrars and others. Personal contact is possible, which expedites the settlement of any difficulties and obviates the necessity of sending representatives of the company served, thereby saving much time and expense.

Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

Preparation in conjunction with other departments of applications for issue and sale of securities and listing securities on stock exchanges.

Tax Service

Examination and advice relative to the Federal tax returns of the companies.

Studies of unusual transactions to obtain maximum proper tax benefits therefrom.

Study and advice relative to the depreciable base and annual rates for the determination of the allowable maximum proper deduction for depreciation on Federal income tax returns.

General advice offered as a result of continual study of the Revenue Acts, the Treasury Department Regulations, court and tax board decisions and related matters.

Preparation of and advice relative to protests or petitions filed with Bureau of Internal Revenue.

Correspondence and personal conferences with the Internal Revenue Bureau at Washington, D. C., regarding items questioned by Revenue Agents as a result of their examination of income tax returns previously filed.

Preparation and assistance on claims for refund filed with the Bureau together with correspondence with and personal conferences in Washington, D. C., on these claims.

Conferences with State tax authorities relative to questions raised upon examination of the returns and basis of determining tax.

Maintenance of records necessary to furnish intelligent and adequate advice concerning tax matters including a continual yearly record of maintenance and retirement data, filing of copies of returns and conducting correspondence concerning such matters.

To intelligently supervise this work requires experts who have made a special study of and are familiar with

Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

the provisions of the Federal Revenue Act relating to Public Utility taxes as well as with the regulations of the Treasury Department. A continual study of the decisions handed down by the Bureau, the courts and the Board of Tax Appeals is necessary to apply such findings to the problems of the companies. If such services were not provided by the supervisory organization it would be necessary for the companies to employ their own tax consultants and assistants or seek advice from outside sources. This alone would not bring to the companies all the benefits they now enjoy since tax problems of many other public utility companies of the system are also handled. The problems so encountered are varied and many, insuring in effect a broad viewpoint of such matters, which would not be the case with a single company.

[R. p. 8075] The experience of the applicant's tax experts with tax measures in various States has been of material benefit in the filing of proper returns and the treatment of various items to obtain maximum benefits in new tax measures adopted. This service reduces considerably the amount of correspondence, study and consideration of the tax measures by employees of the companies.

Accounting Service

Examination of the cost and nature of additional property certified to Trustees.

Preparation of net earnings certificates and other data required to be filed with Trustees.

Preparation of financial and dividend statements for Directors' meetings.

Examination and checking of stockholders' reports and monthly statements and arranging for distribution.

Examination of data supplied to statistical organizations for use in manuals and other publications.

Keeping the books of account and records and preparing consolidated statements of certain companies.

Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

General accounting advice offered and recommendations made as a result of studies of accounting problems, procedure and policy including; distribution of cost of plant purchased, provision for uncollectible receivable losses and establishment of reserves, audit reports and recommendations, advice to improve or eliminate accounting detail consistent with good accounting practice, reports to regulatory bodies, and study of accounting classifications prescribed by Federal and State authorities and advice to companies to assist them in installing same.

Corporation Department Service

In conjunction with counsel, in cases where legal advice is required, and with other departments, the Corporation Department renders services in connection with the following matters:

Preparation of applications and reports to the Securities and Exchange Commission, Federal Power Commission, and other State and Federal commissions with respect to action under State and Federal laws.

Preparation of applications to stock exchanges and personal contact with Exchange officials.

Assists companies in operation under mortgages, such as obtaining releases of property, release of cash, and discharge of mortgages. Prepares release and other applications required to be furnished Trustees.

Assisting in the drafting of indentures, contracts, deeds and other documents.

Coöperates with transfer agents in connection with problems arising on transfers of securities, lost stock certificates, supply of stock certificates and other matters.

Arranges with transfer agents for sending of notices to stockholders for special and annual meetings, obtaining proxies, and other matters in connection therewith.

Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

Prepares matters for action at stockholders' meetings, drafts minutes and keeps records of such meetings.

[R. p. 8076] Prepares data for presentation to Directors other than financial data, drafts minutes and keeps records of such meetings.

Gives notice to appropriate parties of all action taken at meetings of the Directors and stockholders.

Advises Directors and officers of requirements under State and Federal laws, such as the reporting of security holdings, making applications and filing reports for authority to continue or obtain permission to serve.

Statistical and Budgetary Department

Assembles, compares and analyzes financial and statistical data of the companies to permit intelligent analysis of performance and problems in order to recommend improvements in operating efficiency, sound policies in development of the business and to provide information for present and prospective security holders.

This department provides information drawn from a wider field than that available to one company alone from which executives with opportunities for broader experience are able to make recommendations for improvement in performance and for sound development. All of these contribute to lower rates and improve service for the customers and to greater security and profit to the investors and employees.

Weekly data on energy output and transportation receipts which are received from the companies are tabulated, plotted and compared with other business indices.

Monthly financial and statistical reports are reviewed and comparative data are tabulated and plotted. Such information indicates the relative growth of various classes of business and the efficiency of operation in the different properties. Successful sales and rate policies and operating

Engineers Exhibit 229 (Cont'd)

EXHIBITS (Cont'd)

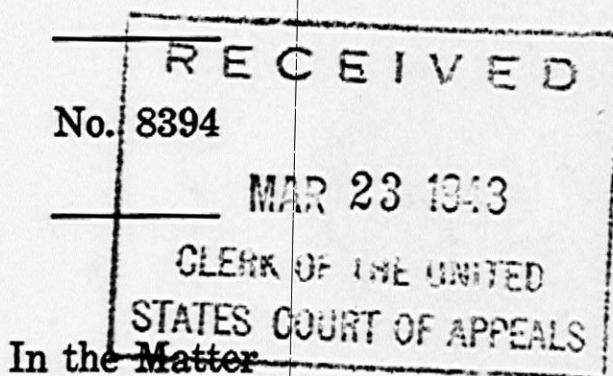
methods in individual properties are disclosed and recommended for use in the others. Comparisons are made from time to time with information from other utility systems.

Special studies are required from time to time of particular problems such as the trends and prospects of particular classes of business to determine whether new activities should be undertaken or old ones expanded, curtailed or abandoned.

Life insurance companies, bankers, investment counsellors, and other large holders and prospective purchasers of securities, located in or adjacent to New York, are continuously analyzing the performance and conditions of the companies, and considerable time is required to answer their inquiries regarding financing, earnings, mortgage provisions, franchises, etc., by telephone, by mail or through personal calls.

SUPPLEMENT TO BRIEF FOR RESPONDENT

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA



of
ENGINEERS PUBLIC SERVICE COMPANY
and
ITS SUBSIDIARY COMPANIES

ENGINEERS PUBLIC SERVICE COMPANY, et al.,
Petitioners,
against
SECURITIES AND EXCHANGE COMMISSION,
Respondent.

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SUMMARY OF REPORTS BEFORE CONGRESS WITH RESPECT TO PUBLIC UTILITY HOLDING COMPANIES SUPPLEMENTED BY MATERIALS OF SIMILAR NATURE COLLECTED SINCE 1935

Purpose of Summary

There are presently pending in three different Circuit Courts of Appeals and in the Court of Appeals for the District of Columbia some eleven petitions to review orders of the Commission under Section 11 of the Holding Company Act. These cases have in common the contention that Section 11 is unconstitutional because not "reasonably related to" the exercise of the powers of Congress over interstate commerce and the mails.

In view of the obvious relationship between holding company activities and interstate commerce, and in view of the decision in the *Electric Bond and Share* case¹ that it is within the powers of Congress to subject public utility holding companies to some regulation, we understand that the argument essentially challenges the reasonableness of the particular method of regulation involved. If courts may heed this argument at all, they are called upon to exercise the delicate responsibility of determining whether a coordinate branch of the government has acted outside the bounds of reason.

The Holding Company Act was passed with express reference both to the comprehensive nine-year study of the industry set forth in the ninety-odd volumes of reports of the Federal Trade Commission,² which has been characterized as "the most thorough-going investigation of an American industry that has ever appeared",³ and to the six volume Splawn Report of the Committee on Interstate and Foreign

¹ *Electric Bond and Share Co. v. S. E. C.*, 303 U.S. 419 (1938).

² Federal Trade Commission, *Utility Corporations*, 70th Cong., 1st Sess., S. Doc. 92, hereinafter cited as *Utility Corporations*, Part —.

³ Barnes, *The Economics of Public Utility Regulation* (1942), p. 71.

Commerce of the House of Representatives.⁴ Moreover, the Act was passed after one of the most bitterly contested legislative battles in our national history, and Section 11 was the focal point of the controversy as to the appropriate scope of the Act. Under the circumstances, a judicial determination that Congress has exceeded the bounds of reason in adopting Section 11 could properly be made only after a careful review of the basic economic data relied on by Congress in passing the Act, supplemented by such more recent data as is available to shed further light on the problems involved. The purpose of this brief is to present an outline of the available data and to highlight the history of abuses which led to the passage of the Act and to the inclusion therein of provisions designed "to compel the simplification of public utility holding company systems . . . and to provide as soon as practicable for the elimination of public utility holding companies except as otherwise expressly provided in this title."⁵ It is hoped that this summary presentation of the economic data will be sufficient to show that the problem involved is essentially one of legislative policy.

A secondary purpose of this brief is to afford a perspective for the diversity of procedural issues which have been raised in the various pending petitions for review. The basic problem underlying all of these diverse procedural issues is whether the Commission, in following the procedures challenged in the several petitions for review, was acting within the limits of its administrative discretion in connection with its duty to enter orders under Section 11 of the Act "as soon as practicable after January 1, 1938."

⁴ "Report on Relation of Holding Companies to Operating Companies in Power and Gas affecting Control", 73d Congress, 2d Session, H. Rep. No. 827, 6 Parts (1933).

⁵ The information presented here is largely based upon the Reports of the Federal Trade Commission on *Utility Corporations*, published releases of the Securities and Exchange Commission, and similar sources.

Part 72-A of the Federal Trade Commission Reports consists of a well-documented summary of the findings of the previous volumes.

This, of course, requires an understanding of the practical administrative problems confronting the Commission. The answer does not rest entirely upon an analysis of the legal arguments which counsel have predicated upon particular phrases in the statute. We believe it is fair to ask the court to review the Commission's handlings of the procedural problems presented in applying Section 11 to any one holding company system in the light of its duty to bring about a comprehensive reorganization of the entire industry.

It was the industry position before Congress that abuses had undeniably occurred, but that the only remedy necessary was to provide for the regulation of future transactions of an objectionable character. Even though past abuses are admitted, it is necessary to consider them in some detail in order to understand why the purely static remedy recommended by industry spokesmen was deemed by Congress to be inadequate and why Congress concluded that a fundamental reorganization of the industry was necessary.

The information summarized in this brief is, of course, largely outside the records of the various cases pending on review but is within the broad scope of judicial notice as exercised by courts in reviewing legislative determinations.

The Monopolistic Character of the Industry

Electric and gas utility companies have, in almost all cases, the power of eminent domain, the privilege of using public streets and highways for the extension of lines or the laying of pipe, and, above all, in complete contrast to our competitive system, they have a monopoly of the production and distribution of a specific utility service in a given area.

The gas and electric utility industries have not always enjoyed monopoly powers; in the beginning competition was relied upon to secure adequate service and fair rates. Duplication of costly facilities was, in general, wasteful, however, and resulted in unnecessary risks to investors

without commensurate advantages to consumers. Consequently, local monopolization of such services was permitted throughout the country. Since unregulated monopolies seek monopoly profits and are admittedly inimical to the interests of the economy, amelioration of the potential abuses accompanying monopoly by state and Federal regulation is an accepted fact today.

Government regulation has been concerned with securing fair rates, adequate service, the protection of the investor, and the confinement of the monopolies within proper spheres. The creation of exceptions to the anti-trust laws to permit *local* monopolization of utility services because competition proved too costly affords no logical justification for *nation-wide* monopolization of such services by a group of financial interests. In large part, Section 11(b) of the Act represents, in a substantial sense, specialized anti-trust legislation whose purpose is to forbid the control of a combination of local monopolies within a holding company system except under prescribed circumstances where there is economic justification therefor.

It should be noted in this connection that there is a substantial body of public opinion which questions the possibility of adequate regulation of powerful monopolies engaged in rendering essential public services. This body of opinion points to the inevitable pressures upon the management of privately-owned public utilities to reach out for political power in order to protect themselves from the possibility of what they may consider excessive regulatory zeal, with consequent corruption of not only governmental authority, but of the sources of public opinion upon which its sanctions must rest.⁶ This problem, which is, of course, in-

⁶ In *Utility Corporations*, 71A, is found a detailed study of what was characterized as "the greatest peacetime propaganda campaign ever conducted by private interests in this country" (p. 391). For over a decade the holding companies and their trade associations were extensively engaged in subsidizing educational activity ranging from grade schools to graduate schools, research projects, and faculty personnel; in

herent in regulated monopolies of any size, becomes magnified in proportion to the size of the enterprise involved. Congressional recognition of the problem is reflected in the Act, not only in those provisions directed at lobbying and political contributions by registered holding companies and subsidiaries, but, also, in the size and other limitations on the permissible scope of holding company systems. As the President said in his message of March 12, 1935 (quoted in S. Report No. 621, 74th Cong., 1st Sess. at p. 2) :

“Regulation has small chance of ultimate success against the kind of concentrated wealth and economic power which holding companies have shown the ability to acquire in the utility field. No Government effort can be expected to carry out effective, continuous, and intricate regulation of the kind of private empires within the Nation which the holding company device has proved capable of creating.

“Except where it is absolutely necessary to the continued functioning of a geographically integrated operating utility system, the utility holding company with its present powers must go.”

Protection of the public against extortionate charges is not the only problem presented by the monopolistic characteristics of public service companies. There is the problem of preserving competitive conditions among those individuals and firms whose livelihood depends upon doing business with the monopolistic enterprise. This problem is also aggravated in proportion to the size of the enterprise; it furnishes further support for the reasonableness of Congress' decision to confine the operation of the holding company systems where it cannot be shown that the benefits re-

(Footnote 6 continued)

financing news services releases and canned editorials; and in carrying out extensive speaking programs. Including advertising, the annual expenditure for these purposes exceeded \$30,000,000 annually. Customer ownership drives, which sold investors millions of dollars worth of questionable securities, were an additional feature of the nationwide program. For a concise summary of these activities, see Barnes, *supra* note 3, Chapter XXIII, “Public Relations and Propaganda”.

sulting from combinations of operating properties are commensurate with the disadvantages of increased size. The same message of the President also stressed this aspect of the problem:

"Most of us agree that we should take the control and the benefits of the essentially local operating utility industry out of a few financial centers and give back that control and those benefits to the localities which produce the business and create the wealth. We can properly favor economically independent business, which stands on its own feet and diffuses power and responsibility among the many, and frowns upon those holding companies which, through interlocking directorates and other devices, have given tyrannical power and exclusive opportunity to a favored few. It is time to make an effort to reverse that process of the concentration of power which has made most American citizens, once traditionally independent owners of their own businesses, helplessly dependent for their daily bread upon the favor of a very few, who, by devices such as holding companies, have taken for themselves unwarranted economic power. I am against private socialism of concentrated private power as thoroughly as I am against governmental socialism. The one is equally as dangerous as the other; and destruction of private socialism is utterly essential to avoid governmental socialism."

Regional Character of the Industry

The electric utility industry, unlike most other major industries, is from an operating point of view essentially localized. By existing means, power can be transmitted economically for only limited distances. Most power is consumed within 300 miles of its place of generation.^{6a} In the manufactured gas industry, economical transmission is much more limited. Consequently, in contrast to the telephone industry, there can be no operating economies in the organization of these industries on a national scale.⁷

^{6a} *Energy Resources and National Policy*, National Resources Committee (1939), pp. 268-270.

⁷ The only possible economies in the control of these industries by a holding company whose subsidiaries are widely scat-

Regional power groupings on an integrated basis correspond to the economic needs of the industry and are the desirable corporate pattern in the present state of the art.⁸

Growth of Holding Company Systems

Holding companies which now dominate the utility industry have had diverse origins. The Electric Bond and Share system and The United Gas Improvement system originated in the efforts of manufacturers of electrical and gas equipment to find a market for their products.⁹ Since the early public utility industry had difficulty in raising capital, the manufacturers of equipment were able to sell their product only by accepting payment in the form of securities. These securities were converted into cash by organizing a holding company to hold them and selling holding company securities to the public.

In time, promoters and speculators set up holding companies to acquire utility operating companies throughout the country in order to share in the profits which the older holding companies had demonstrated could be quite sub-

(Footnote 7 continued)

tered lie in the more efficient use of top holding company personnel and in the joint servicing of subsidiaries by a system service company or by the holding company staff. The investigations of the Federal Trade Commission and other investigatory bodies, as indicated *infra*, reveal that, typically, the top holding company personnel has been preoccupied with advancing the interests of the common stock of the holding company or its own personal fortunes, rather than being concerned with serving the consumer, and that servicing of subsidiaries has been the source of some of the most flagrant abuses in the history of American finance.

⁸ These are the findings of Congress in Sections 1, 10(c), and 11(b), based upon the reports and findings of the Federal Trade Commission, the Committee on Interstate and Foreign Commerce of the House of Representatives (the Splawn Report) (see Section 1(b) of the Act) and the Report of the National Power Policy Committee to the President (S. Report No. 621, Committee on Interstate Commerce, 74th Cong., 1st sess. (1935) pp. 55-60).

⁹ *Utility Corporations*, 72-A, pp. 86, 102.

stantial. The older holding companies themselves quickly departed from their original function of financing the sales of their equipment or services and embarked on a vast program of territorial expansion in order to build extensive utility empires. These utility empires grew enormously in the speculative period preceding 1930. The Associated Gas and Electric system, now in bankruptcy, grew from approximately \$4,000,000 in assets in 1922, to \$835,000,000 of assets in 1930. The exploitation of operating properties by exorbitant service charges and the device of "pyramiding" which enabled promoters to acquire properties with the minimum of investment and risk of capital made it appear highly profitable to acquire control of any utility property located anywhere in the country and even in foreign countries. Consequently, practically all utility systems, whether of promotional or other origin, engaged in severe competition with each other for the acquisition of operating properties.¹⁰

Concurrently with the fantastic stock market prices of the late '20's, highly inflated prices were paid for utility securities and properties by holding companies which, thereupon, issued their own securities to the public based on such inflated values. Those securities are, generally speaking, outstanding in the hands of the public and are one cause of the needed corporate reorganization and simplification of the industry. Equally, the acquisition of utility properties, irrespective of any economic or functional relations to other properties in the system, resulted in highly discordant utility groupings. These are two of the basic problems which the industry faces and which Congress attempted to meet in Section 11(b).

Concentration of Control

The great growth of holding company systems occurred from the end of the first World War until the depression of the 1930's. A study by the United States Department of

¹⁰ *Utility Corporations*, 72-A, pp. 60-82.

Agriculture in 1914 indicated that in that year the holding company was not an important factor in the electric utility field.¹¹ By 1929, however, as a result of the speculative wild-cat acquisitions of utility properties of that era, holding companies controlled the utility field. The United Corporation group, whose subsidiaries and affiliates include The United Gas Improvement Company, Public Service Company of New Jersey, Columbia Gas & Electric Corporation, Niagara Hudson Power Corporation, American Water Works and Electric Company, Inc., and The Commonwealth & Southern Corporation, had approximately 20% of the total quantity of electric energy generated by private companies in the United States. The Electric Bond and Share Company group had approximately 14%, and the Insull interests were third with over 10%. These three large groups generated approximately 45% of the total for the privately-owned electric utility industry. An additional 35% was controlled by twelve other large utility systems, making a total of over 80% controlled by approximately fifteen companies.¹² In 1929 and 1930, twenty large holding company systems controlled 98.5% of the transmission of electric energy across State lines.

The rise to power of the large holding company in the gas utility industry has been no less startling than in the field of electricity. In 1932, eleven holding company systems controlled 80.29% of the total mileage of natural gas pipe lines, upon which the gas fields are almost completely dependent for the marketing of their product.¹³

Even these figures, however, fail to reveal the extent of the concentration of control in the industry. In addition to its dominating position in its subsidiary and affiliate companies, aggregating over 20% of the industry, The United Corporation, by virtue of its large stock holdings, is in a

¹¹ Id. at pp. 34-36.

¹² Id. at pp. 37-44.

¹³ Report of the National Power Policy Committee to the President, *supra* note 8, p. 55.

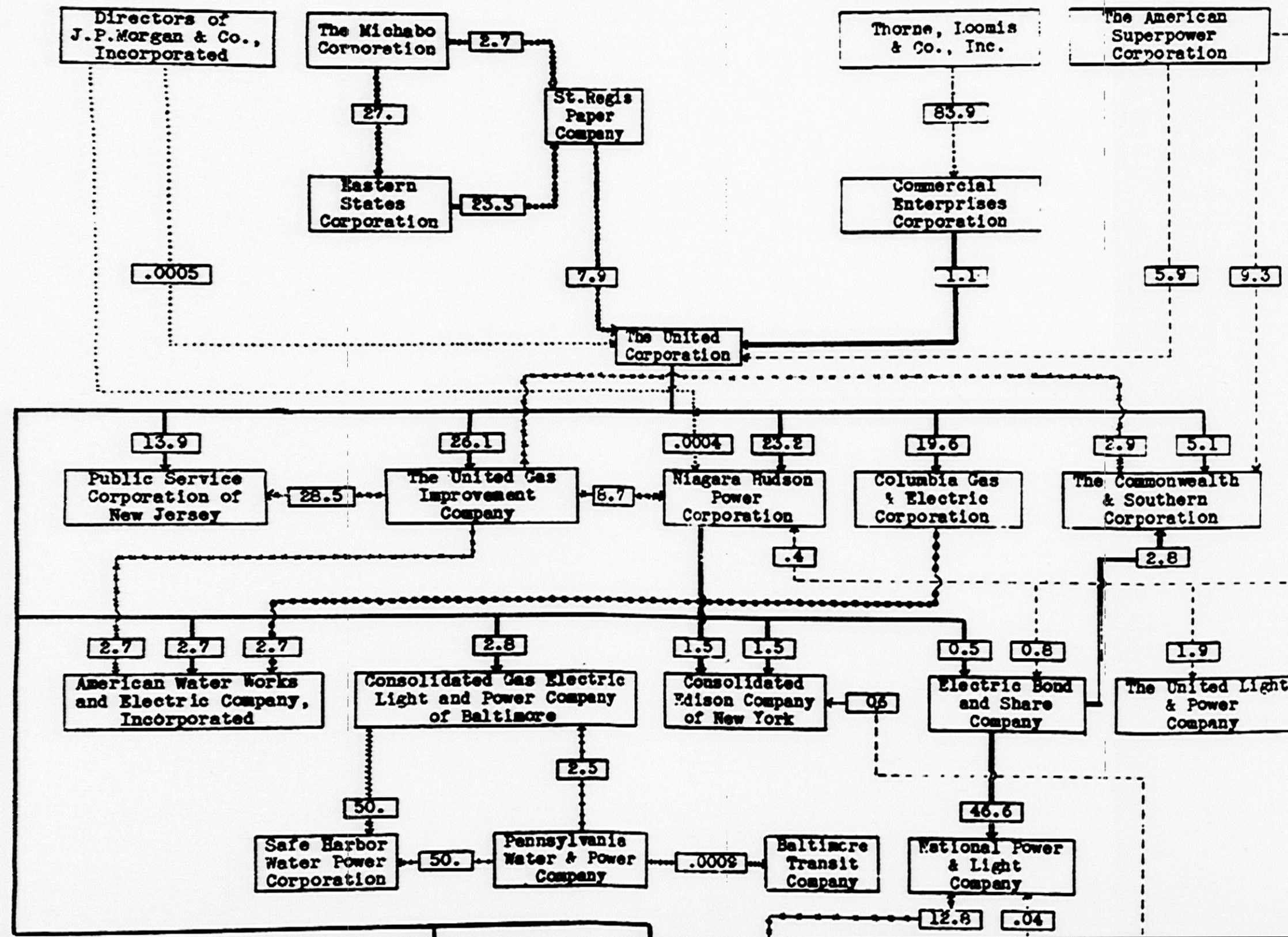
position to influence the policies of a number of other major holding company systems. United and its subsidiary, Niagara Hudson, are the largest common stockholders of Consolidated Edison of New York, whose capitalization exceeds \$1,250,000,000; United is also the largest stockholder in Consolidated Gas and Electric Power Company of Baltimore, whose capitalization exceeds \$150,000,000; United and its subsidiaries, Columbia Gas & Electric Corporation and The United Gas Improvement Company, are three major common stockholders of American Water Works and Electric Company, Inc., whose capitalization approximates \$350,000,000. Furthermore, the two largest groups, The United Corporation and Electric Bond and Share, had substantial interlocking stock ownerships, United having been one of Bond and Share's largest stockholders. Similarly, Bond and Share has been the third largest stockholder in The Commonwealth & Southern Corporation; The United Gas Improvement Company is the largest stockholder in Public Service Corporation of New Jersey, the second largest in Niagara Hudson Power Corporation, and the fourth largest in The Commonwealth & Southern Corporation. Comparable interlockings exist in many other systems.

Attached is a chart submitted as an exhibit in the proceedings with respect to The United Corporation now pending before the Commission under Section 11(b) of the Act. The chart indicates the scope of influence and control concentrated in this holding company system.

The ultimate of concentration of power appeared in the instances where there were dominating personalities who dictated the growth of the system and completely controlled its relations with investors, consumers, and with other businesses. Thus, Insull controlled the Middle West Utilities system until his spectacular flight to Greece, pursued by Federal and State officers; Associated Gas and Electric Corporation was controlled by H. C. Hopson until the bankruptcy of the system and his subsequent imprisonment for defrauding investors and consumers of more than \$20,000,-

CHART SHOWING VOTING STOCKHOLDINGS IN CERTAIN CORPORATIONS INCLUDING THE UNITED CORPORATION

(Based on information furnished The United Corporation)
(by the various other companies)
(as of September 30, 1941)



Legend

The Michabo Corporation	)	The United Gas Improvement Company	----
St. Regis Paper Company	)	Columbia Gas & Electric Corporation	----
Eastern States Corporation)	----	Electric Bond and Share Company	----
Directors of J.P.Morgan & Co., Incorporated	----	The Lehigh Coal and Navigation Company	----
The American Superpower Corporation	----	Consolidated Gas Electric Light and Power Company of Baltimore	----
Thorne, Loomis & Co., Inc.	----	Pennsylvania Water & Power Company	----
The United Corporation	----	Commercial Enterprises Corporation	----
Niagara Hudson Power Corporation	----		

Corporate changes

Consolidated Edison Company of New York formerly Consolidated Gas Company of New York
 Eastern States Corporation formerly Eastern States Power Corporation
 The Michabo Corporation formerly F. L. Carlisle & Co., Inc.
 Mohawk Hudson Power Corporation consolidated with Niagara Hudson Power Corporation
 Baltimore Transit Company formerly The United Railways & Electric Company of Baltimore

NOTE: The United Corporation disposed of its holdings in Electric Bond and Share Company subsequent to September 30, 1941.

000; Cities Service Company was controlled by H. L. Doherty until his recent death; the Byllesbys controlled the Standard Gas and Electric system; Sidney Z. Mitchell was the dominating personality in the growth of the vast Electric Bond and Share system; Harrison Williams is the controlling figure in the North American system; Foshay controlled the Foshay system until its bankruptcy and his imprisonment for fraud; Pierce controlled Central Public Utility Corporation, etc.¹⁴

Interstate Character of Electric and Gas Industries

A sizeable portion of the electric power generated in the United States moves across state boundaries. As shown by the latest figures of the Federal Power Commission, 19.8% of the electric power production for December, 1941, or 3,032,486,000 kilowatt hours, was in interstate movement.¹⁵ The vital importance of this movement is not, of course, measured by its absolute amount. In many cases, such as in the Philadelphia area, continued production for the war effort depends on proper coordination of current coming from Maryland, New Jersey and Philadelphia.

As noted earlier, it was found that holding companies controlled 98.5% of electric energy transmitted in interstate commerce.¹⁶ In the interstate movement of natural gas, the holding companies are also dominant. In 1930, the Federal Trade Commission found that holding companies were responsible for 79.5% of the interstate flow.¹⁷ In that year holding companies controlled 23.3% of the production of natural gas.¹⁸

¹⁴ *Utility Corporations*, 72-A, pp. 130-136; See also *Electric Bond and Share Company, et al.*, Holding Company Act Release No. 3750 (1942), p. 19.

¹⁵ Federal Power Commission, "Production and Utilization of Electric Energy in the United States", January 23, 1942.

¹⁶ *Utility Corporations*, 72-A, p. 43, Table 13.

¹⁷ *Id.* at p. 50, Table 16.

¹⁸ *Id.* at p. 48, Table 15.

Although the interstate movement of gas and electric energy is of great direct significance, its importance is dwarfed by the effect on interstate commerce of the electricity and gas which does not cross state lines. Obviously, modern industry would be impotent without these two major sources of power.

The Influence of Investment Bankers in the Growth of Holding Companies

The Federal Trade Commission investigation and the findings of the National Power Policy Committee disclosed that investment bankers have played a leading role in the growth of the public utility holding company systems. The Federal Trade Commission found that:

“No large holding-company structure has grown to its present size without the aid of investment bankers, and it is also probably true that not many of the present holding-company structures have developed entirely without opposition from more or less powerful competitive banking groups. In consequence, almost every important holding-company group has more or less close business relations with certain investment bankers and, together with such banking interests, is more or less on the alert to forestall attempts of other holding-company managements, assisted by competing investment bankers, to encroach upon its control. The resulting situation is one in which there is great pressure on holding-company managements to give a great deal of attention to the desires and alignments of investment bankers in the formation and the operation of holding-company groups.”¹⁹

Many of the largest holding company systems were organized by investment bankers for the purpose of obtaining new security clients or protecting existing banking relationships. The super-holding company, The United Corporation, was organized in 1929 by J. P. Morgan & Co.—Drexel & Co. and Bonbright & Co., investment bankers, for such

¹⁹ Id. at 72-A, p. 75.

purposes.²⁰ J. P. Morgan & Co. and Bonbright & Co., and their instrumentalities, The United Corporation and American Superpower Corporation (controlled by the then Bonbright & Co.) and related interests subsequently organized two other vast holding company systems, The Commonwealth & Southern Corporation, with \$1,168,000,000 of consolidated assets, and Niagara Hudson Power Corporation, with approximately \$620,000,000 of assets.²¹ Thus, the bankers behind The United Corporation found themselves "in practical control of a network of utilities that extended with only one important break from the Great Lakes and the St. Lawrence River to the Gulf of Mexico."²²

Similarly, H. M. Byllesby, investment bankers, controlled the vast Standard Gas and Electric system, comprising over \$820,000,000 of assets. This system was subjected to intense and bitter competition between various investment banking groups for control, as a result of which investors lost heavily as the bankers fought each other with

²⁰ Id. at pp. 76-77, 111-116.

See letter of Thomas S. Lamont, partner of J. P. Morgan & Co., dated January 2, 1929, in regard to the organization of The United Corporation:

"In this connection the names of two other investment trusts occurred to me, the purposes of which are in a way similar to the one proposed, in that they make little if any pretense of diversification, and their purpose is obviously to insure continued control by the bankers . . . and their clients."

This letter is cited in the Commission's Findings and Opinion in *The Dayton Power and Light Company*, 8 S. E. C. 950,959 (1941), where the Commission found that Morgan Stanley & Co., Incorporated, an investment banking offshoot of J. P. Morgan & Co., stood in such relationship to the Columbia Gas and Electric Corporation system, a subsidiary system of The United Corporation, that there was liable to be an absence of arm's-length bargaining with respect to underwriting transactions between them. The Commission's Findings were affirmed in *Morgan Stanley & Co. Incorporated v. S. E. C.*, — F. (2d) — (C. C. A. 2d, 1942).

²¹ Id. at pp. 111-116, 168-169.

²² Id. at p. 111.

such financial weapons as market pools and manipulations, formation of new super-holding companies, voting trusts, and the switching of control from one system company to another.²³ In the course of one market pool operation, the stock of Standard Gas rose to \$243 per share and fell shortly thereafter to \$79 per share.²⁴ Some six years later, Standard Gas was forced to file a voluntary petition in bankruptcy.

These typical instances underlie the findings of the National Power Policy Committee that:

²³ The sordid history of the bankers' struggle for control of this huge system is found in *Utility Corporations*, 36, pp. 261-663, and is summarized in *Utility Corporations*, 72-A, pp. 80-81, and in *H. M. Byllesby & Company*, 6 S. E. C. 639, 642-644 (1940), wherein the Commission found:

"Byllesby, by virtue of its domination of Standard Gas, caused Standard Gas and its subsidiaries to enter into transactions involving the purchase and sale of utility properties and securities, which netted Byllesby large profits. Through affiliated management corporations Byllesby likewise profited from charges for engineering, construction, legal, and similar services to Standard system companies Illustrative of these transactions is the acquisition by Standard Gas of a controlling interest in the Philadelphia Company and affiliated corporations. For negotiating this transaction, Byllesby and Ladenburg, Thalmann & Co., a banking concern which previously controlled the Philadelphia Company, obtained a profit of over \$16,000,000

"By September 1929 other interests, including a number of investment bankers, had accumulated substantial quantities of the common stock of Standard Gas, with the purpose of obtaining a voice in the management of that company these interests pooled their stock in the United States Electric Power Corporation . . . (. . . 'U. S. E. P.'), which they organized. There ensued . . . 'a real fight for control' between Byllesby and . . . U. S. E. P. . . . which endangered the banking position theretofore enjoyed by Byllesby. . . . The result of the fight for control was an agreement between the conflicting interests, involving, among other things, . . . the allocation among the parties of specified percentages in future underwritings of securities in Standard Power, Standard Gas, and their subsidiaries."

²⁴ *Utility Corporations*, 72-A, p. 80.

“Fundamentally, the holding company problem always has been, and still is, as much a problem of regulating investment bankers as a problem of regulating the power industry.”²⁵

Evasion of State Regulation by Holding Companies

As the facts hereafter developed will show, State regulatory efforts were largely circumvented through the device of the holding company. Management and control were shifted from the operating public utility company subject to State regulation to the holding company, organized outside the jurisdiction of the State. State commissions were forced to deal with local officials who had to look for authority to absentee managers. These absentee managers were typically located in remote financial centers, and were interested primarily in the financial emoluments attendant upon control. The pyramid of holding company securities—resting heavily upon operating companies and extracting from them all available income—was completely beyond State regulatory control. In addition, the holding company systems developed such complexities of intercorporate relationships that it was frequently impossible for State authorities to obtain adequate information regarding the effect of holding company control on management, policies, and costs of local utilities.^{25a}

²⁵ Report of the National Power Policy Committee, *supra* note 7, p. 56.

^{25a} In this respect, the National Power Policy Committee found:

“Holding-company operations are too extensive, State commission powers and funds too limited, to make thorough and effective State action possible. And usually the holding companies have purposely arranged their organization and operations to keep out of reach of State regulation; their lawyers have challenged the jurisdiction of such regulation. Generally a holding company itself is incorporated outside the States in which its operating companies are located and carefully does not do business within those States in a manner which will give State

In enacting the Public Utility Holding Company Act, Congress found, in Section 1 (a), that public utility holding company systems are affected with a national public interest in that, among other things,

“ . . . their activities extending over many States are not susceptible of effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies.”

Congress further found, in Section 1 (b) of the Act, that the national public interest, the interest of investors and consumers, is or may be adversely affected

“ . . . when control of subsidiary public utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies. . . . ”

In certain cases, as the Federal Trade Commission's and this Commission's investigations have revealed, holding companies deliberately created corporate complexities to baffle State commissions or to circumvent State inquiry and control. The following letter of S. W. Murphy, president of Electric Bond and Share Company, dated April 18, 1927 (written as a member of the Bond and Share legal department) typifies the attitude and practices of a system controlling 14% of the electric energy in the United States:

(Footnote 25^a continued)

commissions technical power to reach the books and records of the holding company. Even if obtainable, however, such books and records will be comparatively unintelligible and even misleading until uniform accounting methods are made compulsory. There is the further difficulty of allocating the appropriate proportion of the cost of holding-company activities to its subsidiaries in a particular State, coupled with needless waste in having the process duplicated in State after State. These difficulties of State agencies are so fundamental that not even interstate compacts — assuming they could be evolved — can make State regulation practically effective without supplemental help from a Federal law.” *Id.* at p. 57. See also *Utility Corporations*, 73-A, p. 28.

"In connection with the Pennsylvania reorganization proposed by Mr. Root I have the following comments to make:

" . . . As a general comment I suggest that as far as possible both reorganizations be run at the same time and in connection with each other; that is, all agreements and all plans of reorganization should be laid so that no one will be able to separate one part of the reorganization from the other part. My reason for this is that while in the Pennsylvania Power & Light reorganization the increase in the Plant Account is apparently not so large, the increase of the Plant Account in the so-called Susquehanna Power & Light reorganization is tremendous . . .

"I suggest, therefore, so that the Commission will find it much more difficult to unravel the cost of the various properties, that we go before them with a plan that contemplates both the transfer of certain properties to Pennsylvania Power & Light Company as well as the formation of a new utility company, and also the transfer to the Lehigh Valley Transit Company of the railway properties, so that it will be practically impossible for anyone to find out what the cost of any individual property was or the cost of any particular group of property. I believe that while you could get the Commission to approve your Pennsylvania Power & Light reorganization they would not approve the Susquehanna Power & Light reorganization, but they might be willing to approve the reorganization of all your properties in Pennsylvania if it would be impossible for anyone to determine at what figure the various properties were going into the whole reorganization.

"I again desire to impress upon you the importance, in my opinion, of scrambling all these reorganizations together so that about the only thing the Pennsylvania Commission will be able to understand will be the result and not how the result was reached. Root's reorganization, in my opinion, is too simple and too easy to follow" ²⁶

²⁶ Quoted in *Electric Bond and Share Company, et al., Holding Company Act Release No. 2940 (1941)*. See also

In a number of instances, the Federal Trade Commission found that, in addition to the imposition of various hindrances to State regulation made possible by the device of holding company control, specific State laws applicable to public utility companies have been nullified by holding companies. State laws requiring that utility business be conducted by domestic corporations were rendered meaningless when stock of the domestic corporation was owned by a foreign holding company. Laws designed to prevent security inflation through the provision that securities must be sold at par or fully paid for were readily circumvented by sales to an affiliate within the holding company group for inadequate or dubious consideration.²⁷

The notorious "tree companies" illustrate these practices. Central Public Service Corporation, in order to evade the New York law which forbade acquisition of more than 10% of the stock of an operating utility unless the approval of the Public Service Commission were secured, formed eleven companies bearing the names of trees. Each of these

(Footnote 26 continued)

Electric Bond and Share Company, et al., Holding Company Act Release No. 3750 (1942) p. 32, ft. 71, where the Commission found:

"As a result of the intricate three-cornered transaction between Bond and Share, the subholding companies and the operating companies, it was frequently rendered impossible for regulatory bodies, let alone investors, to determine the extent or the manner of inflation on the books of the operating companies. This problem was rendered particularly acute by the circumstance that the records of the subholding companies were usually located outside the jurisdiction of local regulatory bodies. Even as to federal regulatory bodies, investigation was frequently hampered by the 'unavailability' of key records of the sub-holding companies, as is established by the experience of the Federal Trade Commission and our own experience in the present proceeding as disclosed by the present record. Exhibits in evidence in the present proceeding establish that Bond and Share consciously employed the subholding companies to 'scramble,' and render obscure to regulatory bodies, transactions affecting the accounts of operating companies."

²⁷ *Utility Corporations*, 72-A, pp. 879-880.

companies acquired less than 10% of the New York and Richmond Gas Company, thus complying with the letter of the law. The same holding company circumvented the LaFollette Act, designed to prevent foreign holding companies from acquiring control of operating companies within the District of Columbia. By formation of a trust, having trustees instead of directors, the stock of the Washington Gas Light Co. was acquired without obtaining Congressional authorization.²⁸

Holding companies have also served as a means of escape from State regulation through the creation of service companies rendering managerial, financial, and engineering services, and supplying various types of commodities to utility companies. These activities, if carried on by operating companies themselves, would be subjected to State regulation and their profits would probably be required to be computed in determining an adequate rate of return for the operating company.²⁹ By separating the affiliated service and supply company into a separate company and incorporating it in a foreign State, the holding company has been in a position to impose on operating companies charges far in excess of the restricted rate of return. We shall note hereinafter the extent to which such service charges affected operating company investors and consumers and deceived holding company investors as to the legitimate earning power of their company.

The Public Utility Holding Company Act of 1935 deals specifically with the deep-rooted conflict between the public interest and the use of the holding company device by a small group of men, largely investment bankers, promoters, and highly-paid top figures in holding company systems,

²⁸ *Re New York & Richmond Gas Co.*, 2 P.U.R. (N.S.) 463, pp. 468-470 (1938). Cf. Testimony of Commissioner Robert E. Healy in Hearings Before House Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess., 1935, Pt. 1 at pp. 236-237.

²⁹ Cf. *Hope Natural Gas Company*, Federal Power Commission Opinion No. 76 (1942).

who control vital electric and gas industries throughout the country. This conflict appears in the distorted financial structures produced in the scramble for utility properties and in the efforts to service and preserve such top-heavy financial structures and, secondly, in the discordant and uneconomic groupings of utility properties by the rival holding company systems. These two basic and interrelated characteristics of holding company control and their seriously detrimental effect upon investors, consumers, and the proper functioning of operating companies are outlined below.

Distorted Financial Structures

A. The "Pyramiding" Device

1. The Uses of Pyramiding in the Building of Holding Company Systems

The most distinctive financial characteristic of holding company systems in the utility field is the pyramided structure found in all important holding company groups. The pyramid permits small groups to maintain control of great systems with little or no investment and is the device by which the relatively moderate earnings of underlying operating companies may be transformed under favorable circumstances into earnings of many hundred percent on the common stock of the top holding company which receives the residual income.

Pyramiding is, however, a "fair weather" device. Any decline in the revenues of the underlying operating companies induces an accentuated shrinkage in the return to the top holding company, so that the extreme speculative rises of the boom period are paralleled by the bankruptcies and reorganizations of depression periods.

The following extract from the Federal Trade Commission Report on Utility Corporations indicates the workings of pyramiding:

"A relatively small investment in common stock in the higher levels of a pyramided structure may represent absolute control of underlying operating companies with assets of hundreds of millions of dollars. The fact that public utilities are normally financed to a larger extent than industrials by the sale of bonds and preferred stocks with comparatively low fixed returns and generally with no voice in the management, so long as interest is not in default nor preferred dividends in arrears, is the fundamental basis of the pyramid. It results in absolute operating control by a relatively small investment in common stocks and a very high rate of return on the common stock, provided the operating companies are prosperous, but a low, or no, return on such common stock when the business of the operating companies shrinks.

". . . operating companies whose capital liabilities consist of 50 percent in bonds, 25 percent in non-voting preferred stocks, and 25 percent in common stocks may be absolutely controlled, even under the most adverse circumstances, through the ownership by a holding company of anything over 50 percent of their voting common stock, amounting to 12.5 percent of their outstanding securities. If this first holding company has a capital structure of 50 percent in preferred stock and 50 percent in common, then a trifle more than one-fourth of the capital issues of this company in the form of common stock, in the hands of a second and top holding company, would give it complete control of the first holding company. Thus one-fourth of one-eighth, or $3\frac{1}{8}$ percent, of the total ledger value of the bonds and stocks of the underlying operating companies invested in the common stock of the top holding company of such a three-story pyramid would completely control the operating companies. In actual practice the pyramids are often much more attenuated. For instance, in the case of the Middle West Utilities Co. pyramid, the equity of the top Insull interests representing operating control of West Florida Power Co. amounted to 0.05 of 1 percent of the book investment of the latter company.

"This form of structure has two startling results. The investment representing management control is reduced to a dangerous minimum, and this extremely

thin equity becomes the recipient of any residual earnings over and above the fixed dividends and interest requirements of senior securities. . . . in the electric public-utility industry the tendency has been to regard about 7 or 8 percent as a reasonable rate of return for operating companies. If the rate base on which the return is computed is equal to the book investment of the operating company an 8 percent return is adequate to pay normal interest and preferred-dividend rates for the operating company (with 50 percent in bonds and 25 percent in preferred stock) and leave residual earnings for the common stock which, if passed up through a holding-company pyramid of only two holding companies, in which the common stock is in each case 50 percent of the total capitalization, represent an extraordinarily high rate of return on the common-stock equity representing ultimate control.

"Any reduction below 7 percent for the operating companies, however, encroaches rapidly on the common stock equity earnings; and a decrease, say, to 5 percent, would dry up all earnings for the higher layers of the pyramided structure, so far as those companies depended solely on operating company dividends for income. Whichever is the result, the consequences are unfavorable to investors, on the one hand stimulating a dangerous speculative interest and on the other hand bringing financial loss, and maybe ruin, to many shareholders who regarded the securities of the top holding company as a sound investment.

"None of the large holding-company groups appears to have had a suitable capital structure from an investor's standpoint." ³⁰

Even in the simple situation of an operating company having only one holding company above it, pyramiding and leverage may be extreme. If the operating company has debt and preferred stock and common stock in the ratios of 50%, 25%, and 25%, respectively, the issuance of a substantial amount of senior securities by the holding company results in control of the system by a thin-equity common stock, exposed to sharp fluctuations in income and value.

³⁰ *Utility Corporations*, 72-A, pp. 858-859.

If the holding company above such an operating company itself has a capital structure of 50% debt, 25% preferred stock (75% senior securities), and 25% common stock, there will be only a 6¼% equity in the underlying companies applicable to its common stock; the latter is the subordinate security of a corporate structure composed almost entirely of fixed income securities.

The complicated nature of even the one tier holding company corporate structure can best be appreciated by superimposing it on the operating company and by substituting its security structure for the operating company common stock. If this is done, the holding company debt is seen as nothing more than a junior preferred stock, preceded by the operating company's own preferred stock and bonds. The holding company preferred stock on this basis is a third preferred stock, junior in rank to the holding company debt, the operating company preferred stock, and the operating company debt. If an operating company displayed, directly, a corporate structure consisting of bonds, a first preferred, a second preferred, a third preferred, and a thin-equity marginal common stock, the unsoundness of the structure would immediately be apparent. The intervention of a new corporate entity, the holding company, obscures the fact that such a structure really represents a splitting up of the operating company common stock into several junior preferreds and a marginal common stock. Unfortunately, the investing public has not been able to make such distinctions and it has purchased holding company debt and preferred stock with insufficient realization that they were based only upon the common stocks of operating companies.³¹

³¹ See testimony of Commissioner Healy in Hearings Before House Committee on Interstate and Foreign Commerce on H. R. 5423, 74th Cong., 1st Sess. (1935) at p. 212.

“Commissioner Healy. That is right. That is, you have the spectacle of people buying preferred stock in a holding company saying that they would not touch a com-

In the boom psychology of the 1920's, the prospects of leverage working in reverse appeared highly remote to the promoters and the public was permitted to dwell only upon its speculative possibilities. A new way apparently had been found to make fantastic profits on a small investment. Consequently, the public invested heavily in holding company common stocks in an atmosphere reminiscent of the famous South Sea and Mississippi Bubbles of 1719 and 1720 and the Tulip Mania of 1636.³²

Since pyramiding and leverage presented such rich opportunities, holding companies strove with each other for the acquisition of additional properties. The larger the system the greater appeared the rewards of the residual common stock of the top holding company. On this principle, many of the largest systems were assembled.

2. Pyramiding and Inequitable Distribution of Voting Power

As noted previously, the pyramided holding company structure enabled a few men to acquire control of large sectors of the gas and electric utility industry. The real investors in the system who supplied the capital for the growth of the industry were completely disenfranchised by the pyramiding of holdings, and by such devices as voting trusts, the control of proxy machinery, interlocking directors and officers, management contracts, etc. With no substantial stake in the enterprise, so that control was almost completely divorced from ownership, the interests of the controlling group were frequently divergent from the interests of the

(Footnote 31 continued)

mon stock with a 10-foot pole, and when they look into the portfolio of the holding company and its assets, they see that they are common stocks, and they have bought common stocks without knowing it. And, the same thing is true of bonds. They rest upon those stocks."

³² See Graham and Dodd, *Security Analysis* (1934) Chap. XXVII.

actual investors in the business.³³ Consequently, the rehabilitation of holding company systems, as directed by Congress in Section 11(b)(2), requires that such unfair and inequitable distribution of voting power be corrected, and that the real owners of the business be given an opportunity to elect a management responsive to their interests.

3. Confusion to Investors

The pyramided and complex intercorporate relations within holding company systems create formidable obstacles to an investor seeking to appraise the value and earning power of his securities. Where an investor is required to evaluate the future earnings prospects of holding company securities near the top of a pyramided structure, “. . . he is confronted with the almost impossible task of measuring the magnified impact of income changes at the lower levels of the structure upon those higher in the pyramid resulting from the sharp leverage factor of hyper-attenuated equities.”³⁴

Furthermore, the pyramiding process facilitates the manipulation of accounts, misrepresentation of assets, liabilities and income, and permits the routing of funds and earnings throughout the system as the interests of the top

³³ The Commission recently found that Electric Bond & Share controlled American Power & Light Company, with consolidated assets of approximately \$851,000,000, with an interest representing only 3.42% of the total capitalization of American's subsidiaries, before adjustment for write-ups and probable inadequacy of depreciation reserves. The Commission also found that Electric Power & Light Corporation, with consolidated assets of approximately \$750,000,000, was controlled by Bond & Share with an interest of only 8.72% in the total capitalization of Electric's subsidiaries, before adjustment for write-ups and inadequate depreciation. See *Electric Bond & Share Co. et al.*, Holding Company Act Release No. 3750 (1942), pp. 65 and 66.

³⁴ *The Electric Bond and Share Company, et al.*, Holding Company Act Release No. 3750 (1942), p. 68.

holding company dictate. These factors complicate the problems of appraisal beyond the limits of even the sophisticated investor. This Commission itself has been forced to avow its “. . . inability to reach any meaningful result” in an attempt to appraise the preferred stock of Electric Bond and Share Company.³⁵

4. The Effect of Leverage Upon Investors in Utility Securities

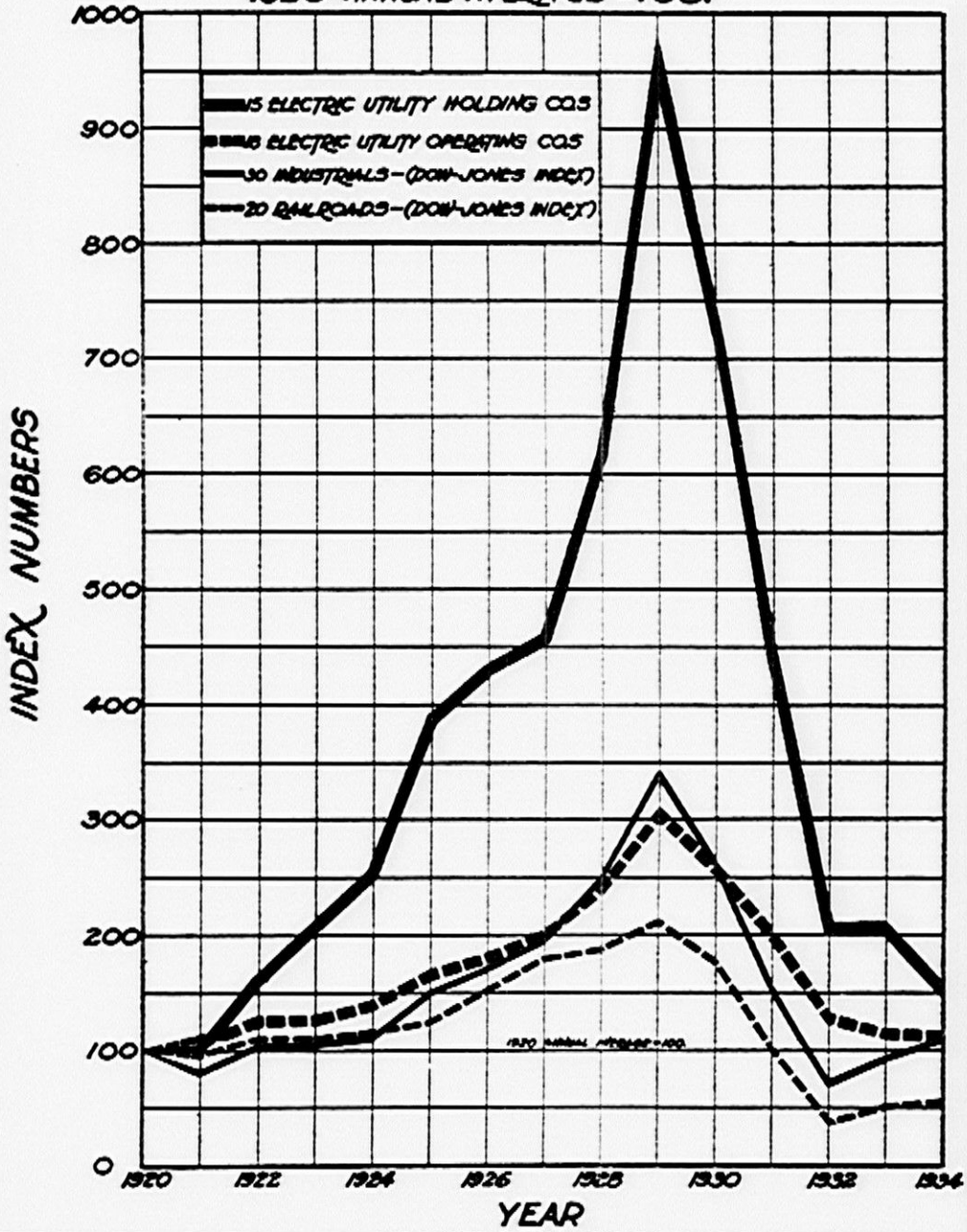
The extreme leverage and speculative character of the common stocks of leading holding companies is illustrated by a consideration of their market price fluctuations. The accompanying chart of market fluctuations in the period 1920-1934 prepared by the National Power Survey (conducted by the Federal Power Commission) shows the rise and fall of a group of representative common stocks of large holding companies as compared with the common stocks of a representative group of publicly held operating companies.^{35a} The spectacular price fluctuations of holding company common stocks in an industry restricted to a fair rate of return indicates clearly their dangerous nature as an investment medium.

The unsoundness of pyramided and overcapitalized holding company structures is demonstrated pragmatically by the bankruptcy and collapse of major holding company systems in the 1930's. Prior to the passage of the Holding Company Act in 1935, holding companies such as the

³⁵ *The Electric Bond and Share Company, et al.*, Holding Company Act Release No. 3750 (1942). See also *The Electric Bond and Share Company, et al.*, Holding Company Act Release No. 2979 (1941), p. 68.

^{35a} This chart appears in Hearings Before Committee on Interstate and Foreign Commerce on H. R. 5423, 74th Cong., 1st Sess. (1935) at p. 2090.

SECURITY PRICES—COMMON STOCK 1920 ~ 1934 1920 ANNUAL AVERAGE = 100.



Foshay Company, Middle West Utilities Company, Tri-Utilities Corporation, Atlantic Gas & Electric Corporation, American Commonwealth Power Corporation, Utilities Power and Light Corporation, North American Gas and Electric Company, Midland United and Midland Utilities, Standard Gas and Electric, Associated Gas and Electric Company, etc., were either in acute distress or in bankruptcy or receivership.

The failure of the pyramiding device is illustrated graphically in the fate of investors who place their funds in "preferred" stocks of holding companies. As of December 31, 1940, preferred stocks of holding companies had a total face value (on an involuntary liquidating basis) of \$2,501,723,000; of this total, more than half, or \$1,442,168,000, were in default. The total outstanding arrears on holding company preferred stocks, as of this date, aggregated approximately \$476,000,000.

Mismanagement and exploitation of operating companies by holding companies, through excessive service charges, excessive common stock dividends, upstream loans, other extortionate intercompany transactions, and an excessive proportion of senior securities, led to serious defaults on even operating company preferred stocks. Of preferred stocks of operating companies in holding company systems totaling \$1,658,677,000 (involuntary liquidating values) at December 31, 1940, approximately \$453,434,000 were in default. Total outstanding arrears on such operating company preferred stocks aggregated \$165,176,000.³⁶ These figures reveal clearly both the injury which pyramiding has caused to the American investors and the unhealthy and complicated corporate structures which characterize a substantial portion of the industry. They also reveal the urgent need for

³⁶ These figures on preferred arrearages are taken from official reports of registered holding companies filed with the Commission. An earlier published report by the Commission "Dividend Status of Preferred Stocks . . ." is based on figures as of December 31, 1938.

corporate rehabilitation and simplification which Congress prescribed in Section 11(b).³⁷

B. Inflation in Holding Company System Assets

1. The Uses of Write-Ups in the Acquisition of Scattered Properties

The write-up was a second major motivating force in the acquisition of scattered utility properties, the creation of sub-holding companies, and the issuance of securities reflecting "watered" assets. Write-ups may be defined as an arbitrary inflationary increase in the book value of an asset in excess of its actual cost.

Without the write-up, the great pyramided holding company structures might not have been built; otherwise, large cash investments would have been required in many instances. The write-up permitted holding companies to acquire valuable properties on a "shoestring" investment by inflating the value of the assets acquired, selling sufficient senior securities to the public to recoup the cash out-

³⁷ The great deflation and collapse of holding companies was not occasioned by any serious reduction or collapse of the earnings in the operating companies. The latter's earnings held up rather well through the depression and subsequent years. In fact, since 1929, State Commissions and the Federal Power Commission have been able to obtain rate reductions aggregating millions of dollars. Middle West Utilities, for example, which went into bankruptcy in 1932, actually had greater gross revenues from its electric and gas utilities in 1931 than it did in 1929 (based on figures reported in Moody's Manual of Public Utilities (1935)). A substantial proportion of its "earnings" had been previously derived from intra-system purchases and sales at inflationary prices. As a whole, the electric utility industry had greater gross revenues in 1936 than it did in the year 1929. See "The Electric Light and Power Industry in the United States," Edison Electric Institute Statistical Bulletin Number 9, 1941 at p. 39. The collapse of pyramided holding company systems, controlling scattered operating companies all over the United States, can only be attributed, therefore, to fundamental unsoundness.

lay, and retaining the controlling common stock for itself at little or no cost. As long as the public would buy the securities, there was every incentive to employ the scheme to acquire any property no matter where located and irrespective of the clear advantages of the property's integration with adjacent properties.

The "typical" pattern of the use of write-ups in the acquisition of utility properties is seen in the Electric Bond and Share system. As the Commission found in *Electric Bond and Share Company, et al.*, Holding Company Act Release No. 3750 (1942) (pp. 30-32), assets of the subholding companies organized by Bond and Share were recorded on their books at sums considerably in excess of their cost to Bond and Share:

"... the subholding company would then issue to Bond and Share and associates senior securities (either notes or preferred stock) in a face amount more than sufficient to cover the cost of the assets turned over to the subholding company, and would also issue substantial amounts of common stock (having a majority of total voting power) against the company's inflated investment account. Bond and Share and associates would sell to the public the senior securities, plus a bonus of common stock, for the approximate face amount of the senior security, thereby recouping all cash outlays; the promoters would then be left with substantial blocks of common stock at no cash cost (sometimes indeed with a cash profit) which they would divide among themselves Thus, Bond and Share would emerge with . . . complete control of the new corporation (and its subsidiaries) . . . and the execution of Bond and Share's standard 'service contract' whereby Bond and Share . . . 'took over the management of the company and its subsidiaries.'

"As a corollary to this method of financing the subholding companies there also invariably resulted a serious inflation in the accounts of the operating company subsidiaries Since the assets received at organization by the subholding companies were generally entered in their book accounts at inflated figures, they were transferred by the subholding companies to the operating companies at sums embodying at least an

equivalent amount of inflation and sometimes a greatly increased amount. In this way there was passed over to the consumer the burden of supporting the watered capitalization of both operating company and the subholding company, while the public investors in the securities of the operating company and the subholding company who may have purchased their securities in reliance on balance sheets containing serious inflation were not informed thereof."

Write-ups and stock-watering have been associated with almost every conceivable form of holding company system transaction—the purchase of operating properties,³⁸ mergers and consolidations,³⁹ voluntary reorganizations and recapitalizations,⁴⁰ the mere transfer of contracts from one company to another,⁴¹ capitalization of excessive service

³⁸ A typical example is found in the organization of the Mohawk Hudson Power Company (Niagara Hudson Power Corporation system). The cost of the properties acquired was recorded at approximately \$37,000,000 and afterwards written up to approximately \$52,000,000—an increase of over \$14,000,000. *Utility Corporations*, 72-A, pp. 226-229.

³⁹ In the consolidation and mergers leading to the organization of Georgia Power Company in 1927 (Commonwealth & Southern Corporation system), the new company emerged with a capitalization reflecting write-ups totaling \$33,453,500. *Utility Corporations*, 72-A, p. 263.

In the organization of Columbia Gas and Electric Corporation in October, 1926, consolidating two predecessor companies, the new company emerged with an inflationary credit to surplus \$69,979,000, the difference between the ledger value of all the net assets acquired and the value assigned to the stocks issued therefor. The Federal Trade Commission reported write-ups of the constituent companies of this system aggregating \$104,833,000. *Utility Corporations*, 72-A, pp. 255, 302.

⁴⁰ A typical example is in the reorganization of the Omaha Electric Light and Power Company into the Nebraska Power Company in 1917. The capitalization of the Omaha company consisted of \$3,789,000, but in the reorganization Electric Bond and Share caused Nebraska Power Company to issue securities totaling \$11,000,000. *Utility Corporations*, 72-A, p. 264.

⁴¹ Thus, Associated Gas and Electric Corporation organized service company affiliates and transferred to such companies service contracts with its subsidiaries obtained without cost to it at arbitrary values totaling \$28,247,400. *Utility Corporations*, 72-A, p. 242.

and construction charges,⁴² arbitrary appraisals by an affiliated engineering staff or a supposedly "independent" appraiser,⁴³ the transfer of properties from one system company to another at fictitious profits and the reflection of such fictitious profits in a write-up upon the books of both the transferror and transferee corporations, etc.⁴⁴

2. Extent of Write-Ups in the Industry

The Federal Trade Commission, in its investigation of the industry, found that, *for the limited number of companies studied*, write-ups exceeded 1.4 billion dollars. The Commission found that the capital assets of operating companies were written up by 22.1%, sub-holding companies

⁴² In the construction of its Valmont plant, Public Service Company of Colorado was required to pay to its holding company, Cities Service Company, a total consideration exceeding the cost of construction by \$6,358,539. *Utility Corporations*, 72-A, pp. 202, 203.

⁴³ Viz., Northern States Power Company (Standard Gas and Electric Company system), recorded a write-up of \$18,378,207 in December, 1924. *Utility Corporations*, 72-A, p. 283. The Metropolitan Edison Company had three write-ups in five years, two while controlled by the Barstow interests and one under the control of the Associated Gas and Electric Company. The three write-ups aggregated \$23,087,475. *Utility Corporations*, 72-A, pp. 285-286.

⁴⁴ Middle West Utilities and Cities Service Company were particularly flagrant in this respect. Central and Southwest Utilities Company, a subsidiary of Middle West, was found to have inflationary items on its books of \$32,337,000, of which approximately \$23,000,000 arose through intercompany profits taken by the various Insull companies in the transfer of properties. *Utility Corporations*, 72-A, pp. 239-240.

The organization of Cities Service Power and Light Company in November, 1924, for the purpose of taking over a substantial proportion of utility securities held by Cities Service Company resulted in an intra-system "profit" of \$59,942,148. Cities Service Power and Light recorded the securities on its books at 165% more than the amount recorded on the books of its parent, Cities Service Company. *Utility Corporations*, 72-A, pp. 240-241.

by 6.5%, and holding companies by 9.6%.⁴⁵ Not all the companies examined revealed write-ups, so that the percentages would be still larger if the write-ups were related only to those companies whose assets were written up in value. In many cases, if the write-ups in operating companies were deducted, little or no equity remained for the common stock. Yet it was on the foundation of this common stock that the holding company structure was based and its securities sold to the public.

The write-ups by individual holding company systems are presented in the accompanying table prepared by the Federal Trade Commission.⁴⁶

3. Write-Downs in the 1930's

In the years following 1929, economic events forced many holding company systems to eliminate some of the inflationary amounts placed on their books when the securities were sold to the public. In 1931, for example, Electric Bond and Share Company wrote down the value of its security holdings by \$441,387,724. In 1932, Niagara Hudson Power Corporation wrote down its investments by \$138,869,250, representing the excess of the carrying value of its investments over the book values of the securities at the dates of acquisition.⁴⁷

In August, 1938, The United Corporation wrote down the carrying value of its investments from \$581,285,000 to \$144,528,000—the market value as of December 31, 1937—thus recognizing the huge loss of \$436,756,943. Since then, the decline in the market value of its assets has continued unchecked. As of March 31, 1942, the market value of United's assets was approximately \$49,131,875, as com-

⁴⁵ *Utility Corporations*, 72-A, pp. 298-304.

⁴⁶ *Id.* at p. 302.

⁴⁷ *Id.* at pp. 302-304.

Summary of write-ups, improperly capitalized intangibles, and inflation included in the capital assets of the top holding, subholding, and operating companies at the final dates of examination, and gross totals of such write-ups.

Group	Top holding Companies	Subholding Companies	Operating Companies	Total
Electric Bond & Share Co.	\$ 8,484,274	\$ -	\$ -	\$ 8,484,274
American Power & Light Co. and subsidiaries	-	5,555,090	93,587,857	99,142,947
Electric Power & Light Corp. and subsidiaries	-	42,341,947	62,531,513	104,873,465
National Power & Light Co. and subsidiaries	-	3,723,958	47,526,594	51,250,552
Total Electric Bond & Share Co. Group	\$ 8,484,274	\$ 51,620,995	\$203,645,969	\$ 263,751,238
Amer. Gas & Elec. Co. & subs. 1/	2,500,000	-	85,992,660	88,492,660
Assoc. Gas & Elec. Co. & subs.	33,362,152	99,269,789	119,830,177 2/	252,462,118 2/
Gen. Pub. Service Co. & subs.	-	15,838,899	-	15,838,899
Cities Service Co. & subs.	35,557,283	92,495,983	134,057,442	262,110,708
Columbia Gas & Elec. Corp. & subs.	47,033,495	2,978,651	52,487,250	102,499,396
W.B. Foshay Co. & subs.	3,020,281	-	4,985,312	8,005,593
Middle West Util. Co. & subs.	34,938,204	33,557,720	42,576,808	111,072,732
New England Power Assoc. & subs.	19,492,089	-	20,469,857	39,961,946
Niagara Hudson Power Corp. & subs.	1,240,538	33,410,002	47,768,670	82,419,210
The North American Co. & subs.	4,223,390	1,862,349	21,909,500	27,995,239
North American Light & Power Co.	23,180,934	-	-	23,180,934
Southeastern Power & Light Co., & subs.	42,632,184	-	79,971,253	122,603,437
Standard Gas & Elec. Co. & subs.	5,400,000	3,132,065	36,854,529	45,386,594
Stone & Webster, Inc. & subs.	-	5,263,498	3,391,695	8,655,193
Tri-Utilities Corporation	7,453,049	-	-	7,453,049
United Gas Improvement Co. & subs.	-	13,940,084	10,290,501	24,230,585
Utilities Power & Light Corp.	4,902,292	-	-	4,902,292
Total	\$273,420,165	\$353,370,035	\$864,231,623	\$1,491,021,823
Percent to total	18.3	23.7	58.0	100

1/ Subsidiary of Electric Bond & Share Co.

2/ Includes write-ups of \$39,980,716 recorded on the books of companies of the New England Gas & Electric Association for consolidated balance sheet purposes only.

Note - Including write-ups in 1929 of \$399,201,827 in the investments of Electric Bond & Share Co. and \$140,109,788 in the investments of Niagara Hudson Power Corporation, the total write-ups for all companies examined amount to \$2,030,335,438. However, Electric Bond & Share Co. subsequently wrote down its investments \$441,387,724 and Niagara Hudson Power Corporation subsequently wrote down its investments \$138,869,250.

pared with the liquidating value of its preferred stock of \$124,435,608,⁴⁸ On a market basis, the preferred stock was "under water" by over \$75,000,000.

The organization of The Commonwealth & Southern Corporation in 1929-1930, was characterized by a write-up in excess of \$531,000,000 over the carrying value of assets on the books of Commonwealth's predecessor companies. Only three years later, in 1933, it became obvious that such inflated carrying values were absurd, and the holding company wrote down its investments by approximately \$563,000,000.⁴⁹

Since the Act became effective, and prior to December 31, 1941, operating companies subject to this Commission's jurisdiction have eliminated nearly three fourths of a billion dollars of "water" from their properties. Holding companies have eliminated over a billion dollars of "water" and have created reserves for future write-downs of more than one half billion dollars. After eliminating intercompany duplication, the total amount of water eliminated from the accounts of holding company systems has amounted to over two billion dollars. Much of this was done without direct compulsion, but in anticipation of possible orders of this Commission, the Federal Power Commission, or the state regulatory agencies. In not a single instance has there been an attempt to seek judicial review of any such accounting requirement imposed by this Commission. Section 11(b)(2) of the Act, directed toward corporate simplification and the removal of undue complexities in holding company systems, is a principal statutory basis underlying these necessary adjustments.

⁴⁸ *The United Corporation*, Holding Company Act Release No. 3592 (1942).

⁴⁹ *The Commonwealth & Southern Corporation*, Holding Company Act Release No. 3432 (1942).

4. Competition for Scattered Properties and the Resultant Inflation of Assets

Overcapitalization of utility operating and holding companies also resulted from excessive prices paid for the acquisition of operating properties. Throughout the late '20's, rival holding company systems engaged in keen competitive bidding for additional properties and, in many cases, paid extravagant amounts for voting stock representing control.

The attitude of the competitors in utility empire building is illustrated by the reported reply of Samuel Insull to shocked protests at the price offered for a particular property:

"Hell's bells! I am not paying for the property, but for location. You can't pay too much when you figure what you can take out of the properties in the future."⁵⁰

A typical instance of the results of such competition is reflected in the fight between The United Gas Improvement Company and the Associated Gas and Electric Company for the control of General Gas and Electric Corporation, a holding company controlling properties in Pennsylvania, New Jersey, New York, Florida, and other states. In order to acquire control of General Gas, Associated Gas and Electric paid \$49,923,855, or \$472 per share for the stock of another company controlling General Gas, which stock had a book value of \$314,614, or \$2.97 per share. The price paid was 159 times the book value of shares purchased. This extravagant purchase resulted in Associated's winning the battle for control of these properties, and The United Gas Improvement Company thereupon sold its large minority interest in them to Associated at a price which netted United Gas a profit of approximately \$9,300,000.⁵¹

⁵⁰ Quoted in Bauer and Gold, *The Electric Power Industry* (1939) p. 152.

⁵¹ *Utility Corporations*, 72-A, pp. 64-75.

Conservative elements within the utility industry have strongly condemned the frantic bidding and excessive prices paid for properties. Samuel Ferguson, president of the Hartford Electric Company, wrote as early as 1926:

"In defense of the practice of purchasing operating companies at from several times the face value of their existing capitalization, and consolidating them into a new company on the basis of the purchase price, it has been urged that the customer cannot be affected by the number of pieces of paper issued by the new company, since he is protected by the limitation of earnings to a fair return on the value of the property. Theoretically, this is so, but practically he does not have a full protection from injury unless injury is by definition limited to the rates charged. The injury from inadequate service and the inability of a company to care for the growth of a community is quite as real, and often much more serious, and yet this must be the result in the case of an overcapitalized company which, through its limitation to a reasonable return on the property value, has earnings insufficient to maintain its credit

"What the public sees is that only a comparatively small fraction of the purchase price is represented by what the company receives for the stock at the time of issue and that the new owners must of necessity earn a return on the whole of the price paid; therefore, regardless of the soundness of the reasons which may justify the transaction, it is only natural to expect that the public will insist on being convinced that its interests are fully safeguarded, and apparently it does not today feel at all sure that such is the case."⁵²

The effects of excessive prices paid for properties have been continuing, including pressure to wring the maximum of income from the costly property, the write-up of operating company assets to correspond to the price, inadequate depreciation, maintenance of high rates, etc. Consequently, regulatory agencies are now requiring that such excess costs, representing purchases at inflated prices, be rapidly

⁵² Quoted in William Z. Ripley, *Main Street and Wall Street* (1926) p. 327-328.

amortized or written off the books.⁵³ Frequently, these requirements will have a serious effect upon the pyramided structure above and will necessitate corresponding drastic adjustments in the capital structure of the holding company.

The results of such overcapitalization and inflation in both operating companies and holding companies is that the public is caught on one or both horns of a dilemma. In the long run, investors will be subject to losses corresponding to the overcapitalization, or the consuming public will be required to pay excessive rates to maintain the inflated capitalizations. In most cases, probably, both groups have shared the burden in that higher rates have served to minimize investor losses. To the extent that high rates are maintained, they stand in the way of industrial, commercial, agricultural, and residential development within the service territory.⁵⁴

C. The Effect of Pyramiding and Overcapitalization on Investors and Consumers

The importance to the pyramided top holding company of comparatively small differences in the revenues derived from operating companies creates a strong incentive to increase operating company income unfairly and to obtain illegitimate revenue directly by the exaction of exorbitant service, management, and other fees. Under such circumstances ". . . few men could be relied on to devote their attention to prudent management of the operating companies, because the speculative element is so overwhelming."⁵⁵ In

⁵³ *St. Croix Falls Minnesota Improvement Company*, Federal Power Commission, Opinion No. 72 (1942).

⁵⁴ The effect of low rates upon the economic development of the territory served is strikingly illustrated in the territories of the Tennessee Valley Authority and the Bonneville Power Authority in the Pacific northwest.

⁵⁵ *Utility Corporations*, 72-A, p. 860.

addition, as pointed out below, the overcapitalized structure of both operating companies and holding companies resulted in constant pressure to exact every possible dollar from operating companies in order to support the outstanding inflated capitalizations. The existence of these forces, in addition to other accompanying pressures, led to many serious abuses in the industry. In Section 1 (b) of the Act, Congress found that the national public interest, the interest of investors and consumers, is or may be adversely affected when

“ . . . securities are issued on the basis of fictitious or unsound asset values having no fair relation to the sums invested or the earning capacity of the properties and upon the basis of paper profits of intercompany transactions, or in anticipation of excessive revenues from subsidiary public utility companies; when such securities are issued by a subsidiary public utility company under circumstances which subject such companies to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions. . . . ”

1. The Maintenance of High Rates

The necessity of servicing “watered” securities and the existence of the pyramid, highly sensitive to every change in operating company income, made many holding company managements resist any rate reduction and engage in protracted and costly rate controversies even when such reductions were required in fairness to consumers. In the case of write-ups, their effect, as Professor Barnes of Yale University has pointed out,

“ . . . was always a distortion of the true rate of earnings, forestalling criticism of rates as too high, constituting an obstacle to any reduction in earnings, and permitting the company to conceal its true financial condition . . . it may safely be affirmed that the net effect was to keep the level of charges to consumers higher than they would otherwise have been. If the connection between write-ups and rates were not more

direct, as it usually was, the deterioration in the investment standing of utility securities could be expected to produce first an increase in the cost of capital and, ultimately, a higher rate of return and higher charges to consumers.”⁵⁶

2. The Pressure to Maintain Extreme Leverage in Operating Company Security Structures.

A striking factor in connection with the capitalization of utility operating companies is the high percentage of debt and preferred stock securities, which involve fixed interest or dividend requirements, as against common stock equity securities.⁵⁷ The extreme proportion of debt and preferred

⁵⁶ Barnes, *The Economics of Public Utility Regulation* (1942) pp. 143-144. See also Utility Corporations, 72-A, p. 327 and Bonbright and Means, *The Holding Company* (1932) pp. 163-174.

⁵⁷ The following table shows on a consolidated basis the ratio of debt and preferred stock securities to net depreciated assets, per books, of eleven large holding company systems:

Ratio of Consolidated Debt, Preferred Stock and Other Senior Claims to Net Depreciated Assets of 11 Large Holding Company Systems at December 31, 1941	
	%
Electric Power & Light Corporation (Electric Bond and Share)	87.6
American Power & Light Company (Electric Bond and Share)	93.9
Associated Gas and Electric Corporation	100.0
Cities Service Company	86.6
The North American Company	73.1
Standard Gas and Electric Company	93.5
National Power & Light Company (Electric Bond and Share)	79.1
Columbia Gas & Electric Corporation	70.4
The United Gas Improvement Company	57.0
The Middle West Corporation*	74.2
The Commonwealth & Southern Corporation	84.8

*Exclusive of Central Illinois Public Service Company

These ratios are based on book assets and are not adjusted for the known “water” existing in asset accounts or for the inadequate depreciation reserves characteristic of most electric and gas utility holding company systems.

stock securities characterizing the electric and gas utility industry appears to be due to a number of factors, including principally:

(1) The efforts of holding company promoters to secure control of utility systems with as little investment as possible; debt and preferred stock securities were normally non-voting, and control could be obtained and retained more easily if the amount of common stock outstanding was relatively small;

(2) Extreme leverage in operating company common stock was considered desirable in the boom days, since it presented speculative possibilities appealing to the high finance psychology of the times and to the over-optimistic expectations of the promoters.

(3) Even subsequent to the acquisition of an operating company by a holding company system, the pressure still remained to maintain thin equity common stocks and their extreme leverage characteristics. The holding company's financial condition has been so poor, generally speaking, and the public has such little confidence in its securities that most holding companies are not in a position to serve as a financing medium for their subsidiaries or to supply them with additional equity capital.⁵⁸ Since the holding company, typically owns and insists upon continuing to own all the common stock of the operating company, the latter company is prevented from doing any equity financing whatsoever. Thus, except for the retention of earnings in the business, the operating company, tied to a sick holding company system, is faced with the prospect of issuing only senior securities for new capital require-

⁵⁸ M. H. Waterman, "Public Utility Financing 1930-1935," Michigan University School of Business Administration, Michigan Business Studies, Volume VII, No. 4 (1936) pp. 558-560.

Even prior to 1935, the studies of Dr. Harold G. Moulton, of The Brookings Institution, summarized in *The Formation of Capital* (1935), showed that very little of the money invested in holding company securities went into productive capital for operating companies. See Report of the Senate Committee on Interstate Commerce on the Public Utility Company Act of 1935, S. Report No. 621, 74th Cong., 1st Sess. (1935), pp. 15-16.

ments.⁵⁹ This impasse can be broken by the enforcement of the integration and simplification requirements of the Act which will either release the operating company from the control of the holding company or result in the latter's rehabilitation so that it is in a position to supply its subsidiaries with equity capital.

In sharp contrast to the position of holding company securities, senior securities of operating companies are among the prime securities of the investment market today and are selling at the most favorable basis in utility history. There is little question that an operating company comprising a strong regional integrated system—the objective of the Act—has no need for financial assistance from any holding company.

(4) Excessive leverage in operating company security structures continues to hold a strong attraction for the holding company. By and large, the holding company has required its operating subsidiaries to finance new capital additions by the issuance of debt rather than equity securities.⁶⁰ It thus obtains 3% to 5% debt money and garners for itself, as the leverage

⁵⁹ See also the statement of Commissioner Robert E. Healy to Leon Jourolmon, Jr., Chairman of the Committee on Progress in Public Utility Regulation for the National Association of Railroad and Utilities Commissioners (Securities and Exchange Commission Release, December 12, 1940) :

“Also in a number of instances operating companies are unable to undertake new financing necessary for new construction because they are tied to the holding company. These include those instances where operating companies need additional facilities, where, due to the policy of the holding company, the operating company has outstanding issues of bonds and preferred stock which are disproportionately large; where the needed new money should be raised on common stock; where the holding company has neither the money nor the credit needed in order to subscribe for common stock, and either cannot or will not permit anyone else to do so.”

⁶⁰ C. W. Kellogg, president of the Edison Electric Institute, estimates that, for the twelve months ended June, 1942, the securities sources of new capital were as follows:

Bonds	\$94,361,000
Preferred Stock	33,486,000
Common Stock	6,732,000

See 10 *Edison Electric Institute Bulletin*, June, 1942, at p. 209.

holder, the difference between such amounts and the 6% or 7% which regulatory authorities permit as the "fair rate of return" on the principal investment. In many cases, the introduction of further leverage elements, coupled with visions of another boom period, represents the holding company's only hope of achieving an equity in the earnings of the underlying company.

This Commission and other regulatory agencies have acted to forestall the issuance of further burdensome senior securities for operating companies,⁶¹ but have encountered considerable difficulties. In the *Virginia Public Service Generating Company*⁶² and *Ohio Public Service Company*⁶³ cases, for example, the Commission was forced to approve the creation of additional corporations with unbalanced security structures, because the operating companies involved were unable to finance capital additions necessary in the public interest.

Relief from these pressures will only be obtained by the corporate simplification and the elimination of the heavy pyramiding and leverage characteristics of holding company systems.⁶⁴

3. Excessive Service Charges

One of the principal motives in the acquisition of utility properties by holding company systems was the opportunity

⁶¹ See *Consumers Power Company*, 6 S. E. C. 444 (1939) ; *El Paso Electric Company*, 8 S. E. C. 366 (1940).

⁶² 6 S. E. C. 419 (1939).

⁶³ Holding Company Act Release No. 3428 (1942).

⁶⁴ In the *El Paso Electric* case, *supra* note 61, at 392, the Commission referred to a staff study of the capital structures of a representative group of operating companies, part or all of whose common stocks are outstanding with the public. The Commission noted that the capital structures of these operating utility companies "have a materially smaller proportion of funded debt to total capital and surplus than most subsidiaries of registered public utility holding companies."

which each new property presented for exploitation through excessive service charges.^{64a} The Federal Trade Commission investigation revealed that service contracts have been an important source of revenue to holding companies. The following summary figures from the Federal Trade Commission Reports are typical of the relation of the fees charged to the costs of performing the work.⁶⁵ It should be noted that these costs, as regards their necessity and genuineness, were not checked by the Federal Trade Commission, and, if too high, the rate of profits noted below is understated.

“ . . . Associated Gas & Electric System in a little more than 5 years, 1924 to 1929, had net income of over 6½ millions for management and construction service alone, or 193 percent net profit on service costs, and that in addition it had servicing income on merchandising, purchasing, and other services.

Electric Management & Engineering Corporation, a fully owned subsidiary of National Electric Power Co., in a period of about 4½ years, 1925 to 1929, received a minimum net profit from servicing of \$2,867,000, including servicing fees received from the subsidiaries of National Public Service Corporation, or 171 percent net on costs. This was equivalent to 32 percent of the total amount of dividends which the holding company, National Electric Power Co., received from all its subsidiaries during this period.

Stone & Webster Engineering Corporation of the Stone & Webster group in 4½ years (July 1, 1928, to

^{64a} In Section 1 (b) of the Act, Congress found that the national public interest the interests of investors, and the interest of consumers are or may be adversely affected

“ . . . when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arms-length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present problems of regulation which cannot be dealt with effectively by the States”

⁶⁵ *Utility Corporations*, 72-A, pp. 662-663.

Dec. 31, 1932) had total gross servicing income of a little over \$15,000,000, representing about 92 percent of its total gross income. Total net earnings of the corporation for the period, before deducting Federal income taxes, were more than \$4,600,000, or about 24 percent on total expenses. However it distributed to certain officers and employees above their regular fixed salaries over \$1,500,000 in contingent salaries and charged the same to operating expenses.

Byllesby Engineering & Management Corporation, servicing the Standard Gas & Electric group, had a total net income (almost wholly servicing) during the 11 years, 1919 to 1929, inclusive, of over \$17,000,000, distributing in dividends nearly \$16,900,000 to its one stockholder, Standard Gas & Electric Co. Its lowest ratio of net income to operating expenses was 51 percent in 1928, and its highest 154 percent in 1919.

From 1926 to 1932, inclusive, Columbia Engineering & Management Corporation collected fees from the affiliated Columbia Gas & Electric group for engineering and management servicing amounting to nearly \$15,500,000, on which it incurred expenses of slightly over \$7,500,000, realizing a net profit on costs of servicing of 106 percent.

Buffalo, Niagara & Eastern Power Corporation received from its subsidiary companies over \$5,300,000 as servicing fees from July 1, 1926 to July 31, 1929. Its costs on this servicing was slightly over \$3,100,000, leaving it a net profit of about 72 percent on cost.

Fees for servicing received by the North American Light & Power Corporation and its successor company, from 1924 to 1929 inclusive, amounted to about \$4,600,000. For only 1 year, 1927, were the expenses for this servicing available. The fees for that year amounted to \$760,000 and the cost of rendering the services \$356,000, a net profit on cost of 113 percent.

Electric Bond & Share Co. had a total servicing income in 1927 of \$9,373,000 and in 1931 of \$11,248,000. Of this there was a net profit in 1927 of \$4,969,000, or 113 percent on costs, and in 1931 \$5,701,000, or 103 percent on costs.

W. S. Barstow & Co., Inc. (New York), and its subsidiary W. S. Barstow Management Association, Inc., both servicing organizations for affiliated companies, had for the 3 years and 9 months, 1924 to Sep-

tember 30, 1927, a combined net income (98 percent attributable to servicing fees) of \$4,004,000, or 321 percent on expenses. Of this total net income \$2,122,000 was distributed to 15 officers and employees as so-called 'extra compensation', and in addition 1 of the 15 received \$653,000 under an income-sharing contract, the latter individual receiving almost one-fourth of the total net income under these two forms of extra distribution."

Investors were injured by excessive service charges equally with consumers. Bondholders and preferred stockholders of operating companies obviously suffer a dilution of their earnings coverage, since service fees, as operating expenses, are paid to the holding company prior to the payment of interest and dividends. Minority stockholders are even more directly injured, since income which might otherwise be paid as dividends to *all stockholders* is diverted to the holding company under the guise of "operating expenses." Holding company security holders, though temporarily benefitted by the receipt of unwarranted income, were, paradoxically, injured most of all, since securities were sold to them upon the basis of a holding company income temporarily inflated by exorbitant servicing profits.

The experiences of investors in the former Utilities Power and Light Corporation (now Ogden Corporation) indicate how investors were misled into purchasing holding company securities upon the basis of income inflated by unfair servicing profits. In 1927, an issue of \$20,000,000 of debentures of this corporation was sold to the public on the representations of a total corporate income of \$2,136,933. Of this total, \$1,719,063 constituted servicing profits and profits on the sale of securities. In 1929 the holding company issued and sold \$36,000,000 more of such debentures to the public. In that year, \$2,500,000 out of a reported income of \$7,525,322 represented servicing profits. During the same period substantial amounts of preferred stock were sold on the basis of these questionable earnings.⁶⁶

⁶⁶ *Utility Corporations*, 54, pp. 1026-1067.

When public opinion stepped in to stop such "milking" of operating company properties, the remaining income available to the holding company was frequently insufficient to meet interest and dividend requirements on its outstanding securities. Bankruptcy, the accumulation of heavy unpaid dividend arrears on preferred stock, or, at a minimum, the cessation of common dividends became inevitable.

This Commission's somewhat incomplete study of service charges shows that in excess of \$60,000,000 a year was extracted from operating companies during the period of unregulated holding company control. The contrast today is unmistakable. Figures submitted by service companies under this Commission's jurisdiction indicate that annual charges to operating companies are now approximately \$20,000,000 a year, or a saving of approximately \$40,000,000 a year to consumers and operating company investors, as a result of the joint efforts of State and Federal regulatory commissions.⁶⁷ Even these charges appear to be excessive in many cases, and the Commission has instituted proceedings against certain holding company systems in an effort to moderate the amounts taken from operating companies. In cases where the holding company is over-capitalized, or otherwise has a complicated corporate structure, the Commission has encountered strong resistance to the reduction of such service charges.

4. Inadequate Depreciation

The requirements of the pyramided and overcapitalized holding company structure for income from subsidiaries and the magnified effect of such income upon the common stock of the top holding company has also resulted in a serious under-depreciation of the electric and gas utility industry. If the annual accruals for depreciation are understated,

⁶⁷ Statement of John W. Houser, Proceedings of the National Association of Railroad and Utilities Commissioners (1941) p. 352.

there is a corresponding overstatement of net income and earned surplus. Investors are given a false impression as to earning capacity and the coverage of their securities. Moreover, if the overstated earnings are paid out in dividends, the financial standing of the company is jeopardized and its capital may be impaired. The failure to accrue sufficient amounts for depreciation also results in an inadequate depreciation reserve and as a consequence the net book value of the company's assets becomes exaggerated. In effect, inadequate depreciation constitutes a subtle way of "watering" stock. The stockholder is paid back his capital in the form of alleged dividends—the stock, however, remains on its books at its full value even though assets reflecting its full value have been drained from the company. Furthermore, inadequate depreciation leads to the issuance and sale of further senior securities which might have been unnecessary had the cash been retained within the business and used for plant expansion.

A major instance of inadequate depreciation as well as failure to retire abandoned property was presented by the financial condition of Middle West Utilities Company and subsidiaries subsequent to the bankruptcy of this system in the early thirties. The receivers of Middle West found grossly inadequate depreciation reserves and, in this connection, made the following statement:

"... Insufficient depreciation charges during past years had in many cases failed to create a proper amount for depreciation reserve against which there could be charged various abandoned properties which, as a result of most careful surveys, was ascertained prior to closing the books for the year 1932. In certain instances it therefore was, or will be, necessary to create capital surplus through the reduction of common-stock capital against which such property abandonment can be charged. . . .

"Declining earnings, the insufficient provisions for maintenance and depreciation made by many of the operating companies and the lack in many instances of adequate reserves against which to write off obvious losses in abandoned properties, investments, inven-

tories, etc., has necessitated a careful review of dividend payments; and as a result, your receivers, in conjunction with various boards of directors, have already during the first year of their administration found it necessary to modify, for the present at least, dividend disbursements of companies under their management to the aggregate extent of over \$12,500,000 annually, and additional revisions will be necessary. . . ."⁶⁸

Depreciation practices in the electric and gas utility industry have a relatively unique characteristic among American industries in that the depreciation reported for corporate purposes differs very substantially from depreciation claimed or allowed for Federal income tax purposes. This is true even though there are many reasons in the case of utility companies which suggest that the amount of depreciation for income tax purposes is generally less than a conservative management would find necessary for corporate purposes.

A recent published study of the Public Utilities Division of this Commission entitled "Depreciation and Dividend Statistics of Electric and Gas Subsidiaries of Registered Holding Companies, 1930-1940", indicates that the difference between depreciation for tax and depreciation for corporate purposes for some 168 companies for the period 1930-39 amounts to \$618,944,000. These statistics also show that if depreciation accruals for purposes of Federal income tax more accurately reflected the actual accruing depreciation, such companies paid out approximately \$273,000,000 more in dividends in 1930-40 than they actually earned.

The implications which may be drawn from these figures as to the inadequacy of depreciation among holding company systems is reënforced by the fact that within the last three years most of such companies have sharply increased their annual accruals for depreciation. These increases have resulted both from the insistence of Federal and state regulatory authorities for more adequate depre-

⁶⁸ *Utility Corporations*, 72-A, pp. 502-503.

ciation and from management's own belated recognition of the ill effects of inadequate depreciation upon investors and consumers. Philadelphia Electric Company, a subsidiary of The United Gas Improvement Company, recently agreed to "freeze" a reported earned surplus of \$10,000,000 and to increase its depreciation accruals by over \$1,000,000 a year, following this Commission's investigation of the adequacy of its depreciation practices.⁶⁹ Georgia Power Company, a subsidiary of The Commonwealth & Southern Corporation, agreed to increase its depreciation reserve by an amount in excess of \$13,000,000—a deficiency represented by excessive dividends paid to its holding company in past years.⁷⁰

Comparable changes are required throughout most of the industry and represent a phase of the needed readjustment of the corporate structure of holding company system companies.

5. The Pressure to Create "Deep Rock" Situations

The marginal position of holding companies in their operating subsidiaries, as a result of the ownership by the holding company of only a thin-equity common stock, has caused many holding companies to attempt to strengthen their positions by requiring the operating company to issue debt securities to them. These debt securities, ranking ahead of the publicly-held preferred stock, were, characteristically, issued for dubious considerations, e.g., holding company loans to enable the subsidiary to pay dividends to the holding company, to embark on ventures primarily for the holding company's benefit, to bolster an initially inadequately capitalized company, advances based on doubtful claims for management and supervision fees, etc. In *Taylor v. Standard Gas and Electric Company*, 306 U. S.

⁶⁹ *Philadelphia Electric Company*, Holding Company Act Release No. 3117 (1941).

⁷⁰ *The Commonwealth & Southern Corporation*, Holding Company Act Release No. 2586 (1941).

308 (1939) (the "Deep Rock" case), the United States Supreme Court held that, under circumstances involving comparable abuses of a subsidiary, holding company debt must be subordinated to the public-held preferred stock of the subsidiary company. A large number of other holding company systems have substantial debt claims against operating companies of similar dubious nature. The protection of publicly-held preferred stock requires a careful consideration of the fairness of such holding company claims and presents one of the most difficult problems in the needed corporate simplification of holding company systems. Significantly, such claims occur most frequently in highly pyramided holding company systems where the equity of the holding company in the common stocks of its subsidiary companies is small and in danger of being wiped out.

Discordant Property Acquisitions

A. Irrational Organization of the Industry

The previous sections have emphasized that the lure of magnified profits through pyramiding and the use of pyramiding and write-ups to acquire control of scattered properties at a "shoe-string" investment motivated the building of many utility holding company systems. It is true, of course, that many mergers and consolidations of operating properties in the utility industry have resulted in a considerable integration and coördination of adjacent properties. To the extent that such adjacent properties were brought together into a single integrated system by the merger of the earlier small units into larger ones or by holding company acquisition, the public interest may have been served. The basic trouble lay not in such acquisitions but in the purchase of scattered utility properties and in the badly discordant groupings of properties between systems.

Many acquisitions or consolidations of property by holding company systems were not planned from the standpoint of public requirements.

In this connection, the National Power Policy Committee found:

"The growth of the holding company systems has frequently been primarily dictated by promoters' dreams of far-flung power and bankers' schemes for security profits, and has often been attained with the great waste and disregard of public benefit which might be expected from such motives. Whole strings of companies with no particular relation to, and often essentially unconnected with, units in an existing system have been absorbed from time to time. The prices paid for additional units not only have been based upon inflated values but frequently have been run up out of reason by the rivalry of contending systems. Because this growth has been actuated primarily by a desire for size and the power inherent in size, the controlling groups have in many instances done no more than pay lip service to the principle of building up a system as an integrated and economic whole, which might bring actual benefits to its component parts from related operations and unified management. Instead, they have too frequently given us massive, overcapitalized organizations of ever-increasing complexity and steadily diminishing coördination and efficiency."⁷¹

The scramble of rival holding company systems to acquire local operating utilities has resulted in undesirable operating conditions. The National Power Survey Map, "Service Areas of Principal Electric Utility Systems in the United States" (1935), published by the Federal Power Commission, reveals that operating properties owned by rival holding companies stretch out across territories in a crazy quilt fashion, irrespective of the power needs of the area served and the needed integration of operating properties.

The results of rival holding company acquisition of utility properties, irrespective of the system's ability to in-

⁷¹ *Supra* note 8, at 55-56.

tegrate the property with adjacent ones, has prevented regional integration, has made power more costly, and has blocked the proper coördination of power resources.⁷² In illustration of the irrational organization of the industry, William O. Douglas, as Chairman of the Securities and Exchange Commission, pointed out:

“For example, an area in a Middle Western state, ideally suited to the operation of a single system or at the most two systems, is actually served by a half a dozen operating companies controlled by as many holding companies. Waste results; power costs are unnecessarily high; returns to investors are affected; and the stability and efficiency of each of the operating units are unnecessarily diminished. . . . One of these companies recently built a new generating plant to provide for a load of less than 10,000 kilowatts. It was located somewhat less than 25 miles from a large efficient plant of a neighboring company which had ample capacity to supply this load. In all probability, if these companies were integrated, duplication would not have been needed.

“Such apparently uneconomic developments often flow from the strategy of immediate expediency, nurtured by individual system rivalries.”⁷³

In many areas, rival systems have checkmated each other's possibilities of integrating adjacent properties and have thus prevented the most efficient utilization of the power resources of the territory. Each one jealously guards its own preserve and will not permit the other to coördinate the utility assets of the area into an integrated system.

⁷² See address of Commissioner Sumner T. Pike, Securities and Exchange Commission, before the New York Securities Dealers Association, March 7, 1941. Commissioner Pike pointed out that the State of Ohio, for example, is split up into more than 50 isolated islands of separate utility properties owned by rival holding company systems and that in many cases system properties are separated from each other by intervening properties of other companies.

⁷³ William O. Douglas, *Democracy and Finance*, “The Case for Integration” (1940) pp. 145-146.

In addition, students of the utility industry point out that there has been a country-wide misintegration of generation and transmission assets. There has been

“ . . . not only uneconomical location and proportionality of generating stations, with consequent waste and duplications, but there have been particularly excessive, badly located, duplicating, overlapping and overcostly transmission lines. These were mostly planned . . . for system advantages, according to dictates of absentee control. The net result is poor economy, unnecessarily high cost of generation, haphazard interconnections, and wasteful transmission. And in most states there are extensive sections without adequate connections and with unjustifiably high cost of power.” ⁷⁴

In the case of the natural gas industry, holding company control has in many cases impaired its economic development. In some major instances, markets covering a substantial portion of the country have been preëmpted by holding company systems and attempts at competition have been suppressed. Columbia Gas & Electric Corporation, a subsidiary holding company of The United Corporation system, has been the subject of numerous anti-trust suits for such activities. In 1935, the Department of Justice filed an anti-trust suit alleging that Columbia Gas and its officers dominated Panhandle Eastern Pipeline Company, a pipeline running from Texas to Indiana, for the purpose of preventing it from competing with Columbia Gas in the eastern half of the United States. Columbia Gas signed a consent decree which enjoined it from interfering in any way with Panhandle's freedom of action in the natural gas business. Subsequently, in 1938, the Department of Justice filed a petition to reopen the consent decree on the ground that Columbia Gas had not actually severed its control over Panhandle and that it continued to prevent Panhandle from

⁷⁴ Bauer and Gold, *The Electric Power Industry* (1939) p. 171; see also Douglas, *Democracy and Finance*, *supra* note 73, pp. 145-148; Pike, *supra* note 72.

entering the eastern market. In 1941, this Commission found that Columbia—despite the anti-trust actions and consent decrees—has continued its domination of the potential competitor.⁷⁵ The losses to consumers in the eastern half of the United States as a result of this suppression of competition are incalculable.

In another instance, Columbia Gas & Electric Corporation purchased control of American Fuel & Power Company and its subsidiaries, for the purpose of preventing competition from this system. In the case of *In re American Fuel & Power Company et al.*, 122 F. (2d) 233 (C.C.A., 6th, 1941), the Circuit Court of Appeals found that Columbia acquired the securities of this company and thereupon proceeded deliberately to wreck it for the purpose of obtaining a monopoly in violation of the anti-trust laws.

There are also strong indications that holding company systems controlling manufactured gas companies have fought against the introduction of natural gas in their territories for the purpose of protecting their investment in manufactured gas facilities. Thus, in *Public Service Corporation of New Jersey*, Holding Company Act Release No. 2998 (1941),⁷⁶ the Commission found that The United Gas Improvement Company combined with its subsidiary, Public Service Corporation of New Jersey, to fight the introduction of natural gas into the Philadelphia and New Jersey areas by Columbia Gas & Electric Corporation.^{76a}

⁷⁵ *Panhandle Eastern Pipe Line Company, et al.*, Holding Company Act Release No. 2778 (1941). The history of the anti-trust litigation is summarized in this opinion. See also, *Utility Corporations*, 84-A, pp. 264-277.

⁷⁶ Affirmed in *Public Service Corporation of New Jersey v. S. E. C.*, — F.(2d) — (C.C.A. 3rd (1942)).

^{76a} The United Gas Improvement Company and Public Service of New Jersey also exerted their combined influence to prevent the Pennsylvania Railroad from purchasing power for the electrification of its lines in New Jersey from a competing utility in New Jersey which was able to underbid Public Service by some \$300,000 a year. Philadelphia Electric Company, a subsidiary of UGI, was a logical competitor for this

Congress found, in Section 1 (b) (2) of the Act, that the national public interest and the interests of investors and consumers are or may be adversely affected

“ . . . when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties; or . . .

“ . . . when in any other respect there is lack of economy of management and operation of public-utility companies or lack of efficiency and adequacy of service rendered by such companies. . . .”

B. The Uneconomical Character of Centralized Servicing of Scattered Properties

The sprawling character of holding company systems raises grave doubts as to whether, under existing haphazard groupings of operating properties, there are economic advantages in centralized control of such properties from the headquarters of a holding company in a remote financial center. To the extent that holding company systems are the products of promotional speculations and bankers' visions

(Footnote 76^a continued)

business but did not seek it until it was clear that Public Service was unable to secure the contract. Eventually, Philadelphia Electric obtained the electrification contract but the Railroad was required to pay \$100,000 a year more than the contract offered by the competing utility in New Jersey. See *Public Service Corporation of New Jersey*, supra.

One obvious source of power which UGI and Public Service could exercise over even so powerful a corporation as the Pennsylvania Railroad is their power, as large consumers of coal and other commodities, to rout traffic as between the Pennsylvania and competing roads. In that connection, we quote from the brief of Public Service before the Commission the following:

“Public Service was not content with the amount of business which it received from the Pennsylvania Railroad, and Mr. McCarter made repeated protests and went so far as to take away from the Railroad a large amount of business which that Railroad had previously had. Between 1932 and 1938 the relations between Public Service and Pennsylvania Railroad were not of the best.”

of an uninterrupted stream of underwriting profits rather than the products of attempts to obtain servicing, operating and financial economies, the holding company structure bears only a fortuitous relationship to the servicing requirements of its subsidiaries.⁷⁷

Where properties are closely connected, a centralized organization may achieve economies, but where properties are scattered in many states, the costs of maintaining central records, of visiting properties, and of making long-distance telephone calls is likely to outweigh the benefits of servicing by remote control.⁷⁸ Since the distant operating properties must maintain a full staff, the activities of the holding company staff or service company frequently duplicate work already done or work which can be done by the staff of the local companies at home.

In addition, minute supervision by the absentee holding company of local operations has tended to create an impotent

⁷⁷ See Edward C. Eicher, "Progress in Service Company Regulation," *Public Utilities Fortnightly*, June 5, 1941, pp. 718-719.

⁷⁸ Prof. C. O. Ruggles, of the Harvard Graduate School of Business Administration, in "Some Aspects of Public Utility Management and Regulation", 14 *Harv. Bus. Rev.* 59 (1935), at 59, 71, has pointed out in this connection:

"Careful students of public utilities have realized for some time that satisfactory results could not be obtained through the management of far-flung operating companies by highly centralized, complex intercorporate organizations. It is a regrettable fact that the managements of some of these super-holding companies have had very little real interest in the prosaic business of furnishing public utility service. They have instead been primarily interested in the issue and sale of securities; and, for that reason, they have sought a form of organization which made it difficult, if not impossible, to check their accounts or subject their management of operating companies to proper supervision and control. . . . Complex intercorporate organizations which are primarily interested in the sale of public utility securities ought to be displaced by integrated systems of such a size that the fullest possible economies may be realized without the evil effects of highly centralized control."

See also Eicher, *supra* note 77.

local management which has little authority on its own account and which is required to seek directions as to the conduct of the local business from a distant holding company office unresponsive to local needs.⁷⁹ The distant office is not omniscient and its unfamiliarity with the many local situations it faces frequently results in decisions contrary to the interests of the community serviced.

The major claim that can be advanced for the retention of control of unrelated properties by holding companies is the possibility that economies may be realized from centralized servicing. It is in precisely this field, however, that consumers and investors have been subjected to the grossest frauds. By and large, it has not been demonstrated that operating companies could not fare as well or better by purchasing needed specialized services at arm's-length bargaining when and if needed from independent engineering and servicing firms.

The fundamental objectives of section 11 in this respect find support in the recommendations of the most thoughtful students of public utilities both in this country and abroad. The Committee on Electricity Distribution, appointed by the British Ministry of Transport, recently reported that the maximum benefits from centralized holding company control occur where the utility properties controlled are physically contiguous, and that such maximum benefits cannot be realized in the association under one ownership and management of properties serving widely separated areas. The British Committee stated:

"It will be apparent that, potentially at least, the system of Holding Companies offers certain of the advantages which we envisage as a result of the amalgamation of the smaller undertakings, such as the benefit of central management, centralized purchasing of materials, provision of adequate financial resources, etc. The evidence which has been placed before us shows that, in fact, Holding Companies have, to a considerable

⁷⁹ See *The North American Company et al.*, Holding Company Act Release No. 3405 (1942) at pp. 18-19.

extent, achieved the advantages just mentioned. They have also, in planning co-ordinated development of their respective groups, in some degree overcome the disabilities involved in the physical separation of the various controlled undertakings.

"On the other hand, the question of the physical contiguity of undertakings must be of major importance in relation to management and technical planning and development, and the maximum benefits of centralized control cannot be realized by the association under one ownership and management of undertakings covering widely separated areas.

"While, in general, substantial economies can be effected by central purchasing being carried out by one controlling organization on behalf of a number of small subsidiary Companies, there is an economic limit to the advantage accruing from large scale purchasing. We are not satisfied that any considerable benefits accrue to the larger subsidiary companies by reason of purchases being carried out by a central organization rather than by these larger subsidiaries themselves." (Report of the Committee on Electricity Distribution, May 1936, sections 287-289).⁸⁰

⁸⁰ The Report of the Committee on Interstate and Foreign Commerce of the House of Representatives, *supra* note 4, the Splawn Report, recommended to the Congress that holding companies be abolished completely. See House Report No. 827, part 2, at VII.

See also Bonbright and Means, *The Holding Company* (1932), at p. 222:

"A sound financial structure, a well integrated system of physically connected utility properties, and a scheme of management services which assures to the public, rather than to the stockholders, the primary advantage of centralized management and control, are more necessary for the country than is the continuance of hectic efforts on the part of the dozen large utility groups to expand their properties at all costs."

Barnes, *The Economics of Public Utility Regulation* (1942), concluded:

"When the Public Utility Holding Company Act became law in 1935, the holding company system in the electric and gas utility industries was so intricate that effective regulation was impossible, so complex that investors could not accurately appraise the worth of their securities, so irrational that the potential economies of centralized

Even if substantial economies could be realized by holding company servicing of scattered properties, the dangers accompanying the resultant concentration of power in the hands of a small group outweigh any such relatively small dollars-and-cents benefits. In this connection, the National Power Policy Committee found that:

"While the distribution of gas or electricity in any given community is tolerated as a 'natural monopoly' to avoid local duplication of plants, there is no justification for an extension of that idea of local monopoly to embrace the common control, by a few powerful interests, of utility plants scattered over many States and totally unconnected in operation. Such intensification of economic power is beyond the point of proved economies not only is susceptible of grave abuse but is a form of private socialism inimical to the functioning of democratic institutions and the welfare of a free people."⁸¹

C. Concentration of Management of Vast Holding Company Systems in a Few Financial Centers

Figures prepared by the Commission as of December 31, 1941, indicate that some 53 holding company systems are registered with the Commission and comprise approximately \$16,000,000,000 of assets (consolidated figures per books). Of this amount, approximately 15.3 billion dollars of assets are included in some 20 major groups, each one of which includes more than \$100,000,000 of assets. The accompanying table shows for each of these major systems the consolidated books assets, the number of states in which subsidiaries operate, the headquarters of the holding company system, the

(Footnote 80 continued)

operation and management could not be realized in practice, and so unnecessarily costly that the interests of consumers in low rates were prejudiced. In the interests of investors and consumers, and as a prerequisite to effective regulation, it was essential to provide for a simplification of the uneconomic complexities and an integration along rational engineering lines." (at page 671).

⁸¹ Report of the National Power Policy Committee to the President, *supra* note 8, p. 55.

average mileage from the headquarters of the holding company to the places where the various operating companies are located, and the maximum of such mileage:^{s2}

It will be noted from the foregoing table that the managements of most holding company systems are concentrated in a few financial centers, particularly the New York metropolitan area. It is also evident that nearly all holding companies control subsidiaries in more than one state and are, characteristically, spread over most of the map of the United States. Several have subsidiaries in a majority of the states of the Union. These subsidiary companies include sub-holding companies, service companies, electric and gas companies, water companies, companies engaged in the ice, coal, and moving picture theater businesses and a heterogeneous assortment of other businesses completely unrelated to the serving of electricity and gas.^{s2a}

Of the holding company systems referred to in the foregoing table, only a minority have operating utility properties which serve the areas adjacent to the headquarters of the holding system. In the case of those systems where the headquarters are remote from operating properties, an idea

^{s2} This table is derived from "Chart Showing Location of Operating Electric and/or Gas Subsidiaries of Registered Public Utility Holding Companies, 1939" and "Registered Public Utility Holding Companies, August 15, 1942", published reports of the Public Utilities Division of the Commission. The data on location of operating companies is based upon 1939 information and do not reflect progress made since that date.

^{s2a} The adventures of United Engineers and Constructors, Inc., a joint enterprise of The United Gas Improvement Company and its subsidiary, Public Service Corporation of New Jersey, in office and apartment building construction resulted in disastrous losses for both UGI and Public Service totaling millions of dollars. See *Public Service Corporation of New Jersey, Holding Company Act Release No. 2998* (1941), affirmed in *Public Service Corporation of New Jersey v. S. E. C.*, — F.(2d) (C.C.A. 3rd, 1942). In this case, Thomas McCarter, Chairman of the Board of Public Service, admitted in testimony that:

"It wasn't our business to take over speculative building, and we shouldn't have done it."

of the magnitude of managerial functions carried out through remote control may be obtained from an analysis of the salary cost and related expenses of the holding company and service company personnel, whose situs of operations is at the headquarters of the system.

The attached tabulation shows the expenses incurred by registered holding companies and their service company subsidiaries in providing central management services for the systems which they control. The holding companies reported are those major systems with headquarters in either New York or Chicago and where the central management is not located in the same general area as the operating companies.⁸³

⁸³ In the attached tabulation there has been excluded from holding company expenses the amounts incurred for taxes. No adjustment has been made for service company expenses billed to the holding company and reported as holding company expenses. To that extent there is some duplication with respect to the total figures shown for holding company and service company expenses. Such amount, however, is not a substantial one in relation to the total figure reported for all companies.

The above expenses include all payments by holding companies and service companies for legal retainers and other special services incurred by the central management of the holding company system. The amounts reported do not include payments by subsidiary operating companies for legal and other special services not cleared through the service companies and charged to the operating companies.

Name of System	: Approx. Consolidated : Assets : Dec. 31, 1941	: Location of ² : : General : : Headquarters:	Number of ² : Utility : Subsidiaries:	Number of ² : States Where : Subs. Operate :	Maximum Distance ² : Headquarters to : Sub.	Average Distance ² : Headquarters to : Sub.
<u>Electric Bond & Share Co.</u>						
American Gas & Electric Co.	\$586,071,057	New York area ³	11	9	800	500
American Power & Light Co.	851,251,525	New York area ³	17	14	3100	2000
Electric Power & Light Co.	749,183,549	New York area ³	9	10	2700	1800
National Power & Light	542,078,708	New York area ³	6	5	1650	900
<u>United Corporation Group</u>						
Columbia Gas & Elec. Corp., The	709,099,107	New York area ³	27	8	825	600
Commonwealth & Southern Corp., "	1,168,019,473	New York area ³	10	10	1350	900
Niagara Hudson Power Corp.	645,323,548	Albany	9	1	---- Not available ----	
United Gas Improvement Co., The ¹	1,446,813,044	Philadelphia	25	9	250.	250
American Water Works and Electric Co., Inc.	484,320,934	New York	14	6	575	400
Associated Gas & Electric Corp.	1,043,325,684	New York	64	26	2500	600
Central Public Utility Corp.	109,390,904	New York area ³	37	18	1650	600
Cities Service Co.	1,086,831,666	New York area ³	33	15	3200	1600
Engineers Public Service Co.	386,234,239	New York area ³	10	15	3100	1650
Federal Water and Gas Corp.	198,168,600	New York area ³	8	4	1350	750
International Hydro-Electric System	629,547,543					
Lone Star Gas Corporation	153,371,919	Dallas	6	3	700	300
Middle West Corporation, The	562,371,709	Chicago	29	15	1300	525
Midland United Company	294,660,318	Chicago	12	3	300	---
National Fuel Gas	108,649,716	New York area	9	2	400	360
New England Gas & Electric Association	106,587,213	Cambridge, Mass.	18	3	125 ⁴	---
New England Public Service Company	207,157,957	Augusta	6	3	250	---
North American Company, The	1,320,480,301	New York area	21	12	1400	1000
Northern State Power Co.	261,630,883	Minneapolis	8	3	---- Not available ----	
Ogden Corporation	169,765,002	New York	11	7	---- Not available ----	
Portland Electric Power Co.	112,570,873	Portland, Oregon	2	2	200	---
Standard Power and Light Corp.	823,842,714	Chicago	26	21	2300	600
United Light and Power Co., The	572,958,641					
TOTAL	\$25,334,026,827					

**TOTAL EXPENSES EXCLUSIVE OF TAXES, CALENDAR YEAR 1941, OF CERTAIN
REGISTERED HOLDING COMPANIES AND THEIR SERVICE COMPANIES**

	Top Holding Companies	Sub-Holding Companies	Service Companies	Total
Electric Bond and Share Com- pany	\$517,205	\$	\$	\$
American Gas & Electric Company		332,886		
American Gas and Electric Service Corp.			3,078,451	
American Power & Light Co.		397,702		
Electric Power & Light Co.		359,240		
National Power & Light Co.		411,616		
Ebasco Services, Inc.			3,993,496	
Totals	<u>517,205</u>	<u>1,501,444</u>	<u>7,071,947</u>	<u>9,090,596</u>
United Corporation	280,886			
Columbia Gas & Elec Corp...		1,032,994		
Columbia Engineering Corp.			1,579,924	
Commonwealth & Southern Corp. (Del.)		680,598		
Commonwealth & Southern Corp. (N.Y.)			2,514,284	
American Water Works & Company		1,331,900		
Totals	<u>280,886</u>	<u>3,045,292</u>	<u>4,094,208</u>	<u>7,420,586</u>
Central Public Utility Corp. ...	19,330			
Total	<u>19,330</u>			<u>19,330</u>
Associated Gas & Electric Corp.	819,616			
Associated Electric Company.		122,775		
General Gas & Electric Corp.		140,237		
N.Y. P.A. N.J. Utilities Com- pany		216,476		
Atlantic Utility Service Co.			1,482,696	
Northeastern Water & Elec- tric Corp.		98,764		
Northeastern Water & Elec- tric Service Company ..			181,437	
Totals	<u>819,616</u>	<u>578,252</u>	<u>1,684,133</u>	<u>3,062,001</u>
Cities Service Power & Light Co.	204,899			
Electric Advisers, Inc.			808,246	
Gas Advisers, Inc.			176,189	
Federal Light and Traction Co.		110,516		
Federal Advisers, Inc.			194,465	
Totals	<u>204,899</u>	<u>110,516</u>	<u>1,178,900</u>	<u>1,494,315</u>

	Top Holding Companies	Sub-Holding Companies	Service Companies	Total
Engineers Public Service Co. . .	\$313,666	\$	\$	\$
Engineers Public Service Co. El Paso Electric Co.		18,070	362,369	
Totals	313,666	18,070	362,369	694,105
Federal Water & Gas Corpora- tion	259,539			
Totals	259,539			259,539
The Middle West Corporation	\$317,903			
Central & Southwest Utili- ties Co.		48,920		
American Public Service Co. Northwest Utilities Co. . .		11,667		
United Public Service Corp. Middle West Service Company		16,524		
		8,005		
			617,168	1,020,187
Totals	317,903	85,116	617,168	
The North American Com- pany	1,109,688			1,109,688
Ogden Corporation	436,578			436,578
Standard Power & Light Corp.	60,465			
Standard Gas & Electric Company		536,378		
Public Utility Engineer- ing and Service Corp.			1,023,205	1,620,048
Totals	60,465	536,378	1,023,205	
United Light and Power Com- pany	359,410			
United Light and Railway Co.		227,623		
American Light and Traction Co.		253,662		
Continental Gas & Elec- tric Corp.		142,605		
United Light & Power Service Company . . .			1,090,813	2,074,113
Totals	359,410	623,890	1,090,813	
				\$28,301,086

Conclusion

The foregoing is by no means exhaustive even as an outline of the economic data supporting Congress' judgment as to the necessity for Federal regulation of public utility holding companies, and for including in the scheme of regulation the provisions of section 11. We believe, however, that the data amply illustrates the facts upon which Congress made the findings in section 1 of the Act as to the adverse relation to the national public interest of the practices and conditions found to exist in the previously unregulated industry, and as to the necessity of a fundamental reorganization of the industry in order to deal with those abuses.

The evils which characterized the promotional era of the late 1920's, and which in the early 1930's confronted investors in holding company securities with such staggering losses, were not susceptible of being dealt with merely through regulation of future transactions between holding companies and their subsidiaries, nor by merely prohibiting future issues of unsound holding company securities or future acquisitions not economically justified. Congress found a utility map of the country which already presented a picture of scatteration rather than a rational integration on a regional basis, and many of the states and cities throughout the country were confronted with absentee management of their local public utility companies. So large a percentage of the utility industry had already been gathered together in a few great holding company systems, that concentration of economic power and inequitable distribution of voting power had reached a point where the only solution was, as the President pointed out, "an effort to reverse that process. . . ." Moreover, regulation of future security issues would not prevent continued trading in presently outstanding junior securities of holding companies, which are little more than gambling counters, or in so-called bonds and preferred stocks of holding companies, which are a snare for the unwary.

On the financial side, it was necessary to face the problem of how to provide a practical basis for financing the needs for new capital of a still expanding industry. Fundamentally this meant making it possible for the operating companies in the holding company systems to obtain additional equity capital. As a result of past abuses and investor losses, the holding companies had lost their glamor. With their complex structures, few, if any, could raise funds from the sale of additional common stocks. Additional issues of senior securities of the top holding companies—assuming they were salable—would only have increased the complications. Many operating companies in holding company systems were also in need of a financial house cleaning. Even where the operating companies happened to be in sound condition, the superimposed holding companies were an obstacle to the operating companies doing their own equity financing.

The half-way measures recommended by industry spokesmen were wholly inadequate to meet the situation. Congress accordingly concluded that a fundamental reorganization of the industry was necessary. To that end, holding companies that served no useful purpose had to be eliminated. Those that might perform a useful function, as a medium for maintaining unified control over related operating properties, needed to be pruned of scattered and unrelated properties and their security structures simplified. It was necessary that their securities should have, so far as possible, the investment characteristics of conservatively capitalized operating companies. Only after this is brought about can holding company securities afford a sound medium of investment or permit the raising of new capital on advantageous terms.

Already substantial progress has been made in administering Section 11. Its feasibility has been demonstrated by the experience of those holding company managements which have seriously come to grips with the problem of compliance. The financial rehabilitation of the large segment of the utility industry included in registered holding com-

pany systems, the elimination of concentrated economic power that serves no useful purpose, and the restoration of localized management in that industry are of vital national importance. It is submitted that Section 11 is both a reasonable and a constructive solution to that problem.

REPLY BRIEF FOR PETITIONERS.

IN THE
United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA

UNITED STATES
COURT OF APPEALS FOR THE
DISTRICT OF COLUMBIA

No. 8394.

FILED MAY 11 1943

IN THE MATTER
of
ENGINEERS PUBLIC SERVICE COMPANY
and
ITS SUBSIDIARY COMPANIES

Joseph W. Steward

CLERK

ENGINEERS PUBLIC SERVICE COMPANY, *et al.*,
Petitioners,
against
SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION TO REVIEW ORDERS OF SECURITIES AND EXCHANGE COMMISSION.

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IN THE
United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA.

IN THE MATTER
of
ENGINEERS PUBLIC SERVICE COMPANY
AND
ITS SUBSIDIARY COMPANIES.

ENGINEERS PUBLIC SERVICE COMPANY,
EL PASO ELECTRIC COMPANY (a Dela-
ware corporation), VIRGINIA ELEC-
TRIC AND POWER COMPANY, SAVAN-
NAH ELECTRIC AND POWER COMPANY,
GULF STATES UTILITIES COMPANY,
BATON ROUGE BUS COMPANY, INC.,
EL PASO ELECTRIC COMPANY (a
Texas corporation), EL PASO AND
JUAREZ TRACTION COMPANY, and
ENGINEERS PUBLIC SERVICE COM-
PANY, INC.,

No. 8394.

Petitioners,

against

SECURITIES AND EXCHANGE
COMMISSION,
Respondent.

REPLY BRIEF FOR PETITIONERS.

Statement.

To avoid repetition, this Brief is limited to a reply to certain points made by the Respondent in its Brief (herein cited as Res. B.). The Court is respectfully referred to the

Main Brief for the Petitioners (herein cited as Pet. B.) for a full statement of the points and argument on behalf of the Petitioners in this case and upon which Petitioners will rely.

I.

As to the Excluded Constitutional Evidence.

With reference to the evidence bearing upon the constitutionality of Section 11(b)(1) proffered by Petitioners at the hearing before the Commission and excluded, Respondent states (Res. B. 61):

“It purports to show that the evils found by Congress to exist and recited in Section 1 of the Act do not in fact exist and that the Congressional findings are erroneous, arbitrary and capricious.”

As stated in Petitioners' Main Brief, however, *the proffered evidence shows rather* (Pet. B 22):

“In short, the proffered constitutional evidence proves factually and conclusively that the provisions and standards of Section 11(b)(1) as to control and size bear no relationship whatsoever (let alone a substantial relationship) to the evils recited in Section 1(b), to be remedied by the Act. It furnishes direct proof that the regulatory means selected are clearly not adapted to the end in view.”

Although Petitioners' Main Brief (Pet. B. 21-22) contains a brief description of the proffered constitutional evidence, there is set forth for the convenience of the Court as Appendix A to this Reply Brief a more detailed analysis of the proffered evidence, together with references to the pages in Volume III of the Appendix to Petitioners' Brief, in which volume the proffered evidence is set forth in full. A reading of this analysis will show that it supports adequately the description thereof in Petitioners' Main Brief and has the effect stated above.

Respondent, in seeking to avoid a proper remand of this case for the introduction of the proffered and excluded evidence argues (Res. B. 61) that the evidence should really constitute part of an "economic brief", and states that

"Cases cited by petitioner as permitting the taking of 'constitutional evidence' deal with constitutional questions depending on the facts of particular situations such as whether a particular rate is confiscatory and not with general over-all facts relating to an entire industry."

Not only is Respondent's argument legally erroneous, but the quoted statement is directly contrary to fact. Indeed, cases where constitutional evidence has dealt merely with a particular situation rather than with an entire industry have been the exception rather than the rule. For example, to mention a few of the cases cited in Petitioners' Main Brief:

In *Weaver v. Palmer Bros. Co.*, 270 U. S. 402 (1926) (Pet. B. 19, 34), the constitutional evidence covered the whole of the blanket and comfortable manufacturing industry and dealt in detail with the materials used and the processes of manufacture in the industry generally.

In *N. L. R. B. v. Jones & Laughlin Steel Corp.*, 301 U. S. 1 (1937) (Pet. B. 18), the constitutional evidence covered extensively the activities of the entire steel industry.

In *Carter v. Carter Coal Co.*, 298 U. S. 238 (1936) (Pet. B. 18), there were substantial findings by the Court below dealing with the entire industry which must have been based upon extensive evidence.

Finally, we may note that in *Polk Company v. Glover*, 305 U. S. 5 (1938) (Pet. B. 19), where the Supreme Court reversed a lower court decision in order that evidence bearing on constitutional issues should be received before such issues were ruled on, the Court stated (p. 10):

"The allegations of the bill **as to trade conditions and practices**, and as to the effect of the required embossing of cans, raise particular questions which can hardly be said to lie within the range of judicial notice." (Emphasis ours.)

Here, then, is an instance where the Supreme Court actually sent back a case for the receipt of evidence expressly stated as covering "trade conditions and practices."

Respondent cannot avoid a remand of this case for the taking of the excluded constitutional testimony merely because this evidence is contained in Volume III of the Appendix to Petitioners' Brief. Since the proffered testimony was material to the issues herein, the exclusion of the testimony is a violation of Petitioners' right to challenge effectively the constitutionality of Section 11(b)(1), and it certainly does not satisfy that right for this Court to disregard this error by considering the testimony as having been submitted by Petitioners as an economic brief.

Under the circumstances the duty of this Court is plain under Section 24(a) of the Act, which provides:

"If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper."

Petitioners, in prayer 3 of their Petition to this Court (Pet. App. 73), requested this Court to direct the case to be reopened before the Commission for the introduction of the excluded testimony. The reason alleged for not having introduced such testimony in the hearing before the Commission is certainly sufficient; it was proffered and excluded by express order of the Commission. Under the law, this Court has no alternative but to direct the reopening of the case before the Commission for the introduction of the proffered testimony bearing on the constitutional issues. Any other disposition would, in itself, directly violate Petitioners' constitutional right to challenge the constitutionality of Section 11(b)(1).

The second argument upon which Respondent seeks to avoid a remand of this case for the reception of constitutional evidence is based upon the claim that Congress acted upon the voluminous reports of the Federal Trade Commission and the Splawn Report of the Committee on Interstate and Foreign Commerce of the House of Representatives (referred to in Section 1 of the Act) and that (Res. B. 62)

“Against this vast array of fact-sources, petitioners now seek to introduce the conclusions of a solitary professor of business administration, employed by petitioners to conduct a survey.”

This argument misses the point entirely. We point out this intensely significant fact: Although Respondent has lodged with this Court for its use a 63 page supplement to its brief, stated to be a summary of the reports referred to, the Court will not find in this supplement a single shred of evidence bearing on the crucial constitutional issue involved in this case, namely, the relationship between the specific remedies and means set forth in Section 11(b) (1) and the attainment of the statutory objectives proposed to be effected by the Act. An examination of said supplement, as well as the reports themselves, will show that the factual data before Congress dealt solely with the “evils” found to exist in the utility industry—evils each of which was remedied by a specific provision of the Act other than Section 11(b)(1). (See Pet. B. 31-32). None of the factual data before Congress dealt in any way with the reasonableness of the integration provisions of Section 11(b)(1) as a means of attaining the objectives sought by the Act. For this reason, there is no clash whatever between the constitutional evidence offered in this case and the factual data before Congress. In other words, Professor Waterman’s exhaustive, factual, statistical and economic studies represent the only factual data before this Court (indeed the only data anywhere in existence, so far as petitioners are aware) bearing upon the constitutional issue in this case, namely, the relationship between the means and reme-

dies embodied in Section 11(b)(1) and the objectives sought to be accomplished by the Act.*

Under such circumstances it is futile for Respondent to urge that this Court fail to remand this case for the reception of this evidence bearing on an issue of vital importance to the Petitioners. The proffered evidence is proper evidence, it is not of a character of which this Court could take judicial notice in an "economic brief," and it represents the only factual data in existence bearing upon the constitutional issue which must be decided by this Court.

The only authority cited in Respondent's Brief (Res. B. 61) for the exclusion of the evidence by the Commission is *Panitz v. District of Columbia*, 72 App. D. C. 131, 112 F. (2d) 39 (1940). As shown in Petitioners' Main Brief, this case is authority only for the proposition that the doctrine of exhaustion of administrative remedies does not require a challenge, before an administrative board, of the constitutionality of an act as a condition precedent to judicial relief. This would seem to constitute in substance an admission by the Respondent that there are no cases which support the action taken by the Commission in excluding the proffered constitutional evidence. For cases holding the contrary and supporting Petitioners' contention that such evidence should have been admitted, refer-

* The fact that the study was made by a "solitary professor" is certainly no valid criticism. After a study of observed facts, Agassiz of Harvard, announced the theory of the ice age, which all of his contemporaries at first laughed at and then confirmed. The fact is that the Federal Trade Commission and Dr. Splawn, at the time they made their reports, could not have had the facts before them which Dr. Waterman uses in his study for the simple reason that a large part of the material which he used as a basis for his study, namely, the reports of the Federal Power Commission, were not published until after the Public Utility Act was passed. For example, no general comparison of bills for Electric service in 18,000 communities throughout the United States was available for Dr. Splawn's study. Also, Dr. Waterman's studies covered the years 1939 and 1940, whereas the data in the reports before Congress related to a period prior to 1935 (see Pet. B. 29-30). No allegation is made by the Respondent as to Dr. Waterman's competency to analyze the available material and arrive at the conclusions which he did. Such a criticism could not fairly be made. As Dr. Waterman states in the rejected constitutional evidence, his study was an objective search for the truth. The fact that, as noted by the Respondent (Res. B. 63, footnote 78) Dr. Waterman may have had some different ideas in 1932, before the facts made the basis of the present study were known to him, merely shows his intellectual honesty in changing his opinion when newly discovered facts indicated that such change should be made.

ence is made to the footnote on pages 22 and 23 of Petitioners' Main Brief.

The issue relating to the admission of the constitutional evidence in this case is one of paramount importance from the standpoint of the protection of the Petitioners' constitutional rights. An indication of the importance of the issue is the fact that the Commission's rejection of the proffered constitutional evidence in this very case was made the subject of and occasion for a twenty-one page article in Pike & Fischer, *Administrative Law*, Current Text, Sec. 45a.22 (1941) entitled "Introduction Before Agencies of Evidence Bearing on Constitutional Issues." Not only does this article criticize the position taken by the Commission in its refusal to receive the proffered evidence (Id. p. 9), but it indicates clearly that regardless of the soundness of the Commission's position, constitutional evidence bearing on the validity of Section 11(b)(1) must be admitted into the record before this Court in some way, in order to protect the Petitioners' right to test the constitutionality of Section 11(b)(1) upon the basis of a proper record as to the factual background supporting their constitutional claims (see id. pp. 4, 14).

Unless this Court remands this case to the Commission with instructions to receive the proffered and rejected constitutional evidence, the Petitioners are left in this anomalous position. Under the statute here involved, a case can only come before this Court for review of an order under Section 11(b)(1) upon a record made before the Commission; the scheme of the Act makes it clear that all relevant evidence should and must be presented to and received by the Commission. The only method, therefore, by which the Petitioners can exercise their unquestioned right to introduce evidence bearing on the constitutional issues here involved is to introduce such evidence before the Commission; otherwise such evidence is not in the record which this Court reviews. It is no answer to say, as respondent does in effect, that since the Commission is not a Court and cannot pass upon constitutionality, the Petitioners should be deprived of their undoubted right to introduce

evidence bearing upon the constitutional issues. If the Act be construed to uphold the Commission in its rejection of the constitutional evidence this construction in itself would be a clear violation of the Due Process Clause of the Fifth Amendment to the Constitution, as tantamount to the denial of a full and fair hearing. Such a construction must be rejected to avoid unconstitutionality.

Under Section 24 of the Act as previously pointed out in this Reply Brief, it seems to be the clear duty of this Court to remand the case with instructions to the Commission to receive the evidence. Dr. Waterman's studies are evidence in every sense of the word and it is no answer to the Petitioners' right to introduce such evidence to say that they can be considered as part of the Petitioners' Brief, unless the Respondent thereby means (which certainly is not clear) that the proffered and rejected evidence may be considered as properly before this Court as substantial uncontradicted evidence, proving the ultimate facts claimed by Petitioners. If this is the position of the Respondent, then Petitioners say that the effect of the evidence is unquestionably to show that there is no reasonable relation between the remedies applied in Section 11(b)(1) and the objectives of the Act. Under such circumstances it would seem that this Court has no alternative but to hold the statute unconstitutional as a violation of the Commerce Clause and the Fifth Amendment.

Petitioners do not believe that Respondent intended that the evidence should be considered as received in evidence for all purposes with the logical results flowing therefrom. Anything short of this position, however, deprives Petitioners of their substantive right to introduce such evidence as a part of their case. If this is not the position of the Respondent, then there would seem to be no alternative other than for this Court to remand the case to the Commission with instructions to receive the excluded evidence.

II.

As to the unconstitutionality of Section 11(b)(1) under the Commerce Clause.

In Petitioners' Main Brief it is argued, among other things, that Section 11(b)(1) is unconstitutional because there is nothing in the Act making an effect upon interstate commerce of ownership by any particular holding company of securities of its subsidiaries a condition to the application of Section 11(b)(1) to that holding company and that the Commission was not required to and did not make any findings in respect of the relationship of such ownership by the holding companies here involved to interstate commerce (Pet. B. 41-42). We believe it clear, and it must be admitted, that under the doctrine of *United States v. Darby*, 312 U. S. 100, 119-121 (1941), any proper Congressional enactment under the Commerce Clause must contain or provide for a determination, either by Congress, by the administrative agency concerned, or by the Court, that the particular activities regulated have an economic effect upon interstate commerce.* See also *Wickard v. Filburn*, 317 U. S. 111 (1942) (Pet. B. 40, 41).

In its brief in this case Respondent argues (Res. B. 54, footnote 65) that since Engineers has registered under the provisions of Sections 4 and 5 of the Act and since Engineers has not applied for exemption under Sections 3(a)(1) and 3(a)(2) of the Act "the Commission was entitled to assume, without express findings, that Engineers was a holding company interstate in nature and engaged in interstate commerce. And Congress was entitled to make a similar assumption as to all holding companies which register and cannot obtain any exemption from registration." This argument is wholly fallacious because an examination of the provisions of Sections 4 and 5 and of Sections 3(a)(1)

* Of course, cases like *United States v. Ferger*, 250 U. S. 199 (1919) involving "An Act Relating to bills of lading in interstate and foreign commerce", which deal with statutes on subjects constituting or affecting interstate commerce in their very nature have no application here, since Section 11(b)(1) is not legislation of this character.

and 3(a)(2) shows that such assumptions, either by the Commission or by Congress, are wholly unwarranted.

Section 5 of the Act contains the machinery for registration. Section 4 sets forth the things which are made unlawful for a holding company to do unless registered, but in addition it contains the following provision:

“Sec. 4(b) Every holding company which has outstanding any security any of which, by use of the mails or any means or instrumentality of interstate commerce, has been distributed or made the subject of a public offering subsequent to January 1, 1925, and any of which security is owned or held on October 1, 1935 (or, if such company is not a holding company on that date, on the date such company becomes a holding company) by persons not resident in the State in which such holding company is organized, shall register under section 5 on or before December 1, 1935 or the thirtieth day after such company becomes a holding company, whichever date is later.”*

The exemption provisions of the Act to which Respondent in its brief refers, read as follows:

“Sec. 3(a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any holding company, and every subsidiary company thereof as such, from any provision or provisions of this title, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers, if—

(1) such holding company, and every subsidiary company thereof which is a public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character and carry on their business substantially *in a single*

* It is pointed out that the Act nowhere requires a company in registering under it to state the reasons leading to the registration. Under these circumstances, if registration is to be made the basis of any assumptions (in the manner proposed by the Respondent), any reason which may have led to the registration is fairly to be included in determining the assumptions which can be drawn therefrom.

State in which such holding company and every such subsidiary company thereof ARE ORGANIZED;

(2) such holding company is predominantly a public-utility company whose operations as such do not extend beyond ***the State in which it is organized*** and States contiguous thereto; * * *.”
(Emphasis supplied.)

Under these circumstances, it is submitted that the only facts which can properly be assumed from the fact that Engineers registered under the Act and has not applied for exemption under Sections 3(a)(1) and 3(a)(2) are the following:

(1) (a) That at some time, perhaps as long as ten years and seven months prior to the passage of the Act, someone (with whom Engineers need not have had any relationship at all) distributed Engineers' securities in interstate commerce, and (b) that some of such securities were held on October 1, 1935, by persons not residents of the State of Delaware in which Engineers was organized.

(2) That Engineers and all of its subsidiaries from which it derives any material part of its income, are not incorporated in a single State.

(3) That Engineers was not predominantly a public utility company whose operations do not extend beyond the State of its incorporation and States contiguous thereto.

From these proper assumptions, it would seem eminently clear that neither the Commission nor the Congress was entitled to make the assumption that "Engineers was a holding company interstate in nature and engaged in interstate commerce", so that the provisions of Section 11 could properly be applied to it.

Examination of the statutory provisions and of the above assumptions reveals that registration and failure to

apply for exemption on the part of a public utility holding company might be dependent *entirely* on considerations having nothing whatever to do with whether such holding company is or is not engaged in, or does or does not affect, interstate commerce. In other words, registration and failure to apply for exemption could be due wholly to the fact that a holding company whose utility business is completely local, happens to be incorporated in Delaware but that its securities were at one time sold, even though by someone else, in interstate commerce and are now held by stockholders residing out of Delaware. Certainly this has nothing to do with whether that holding company is, or ever was, engaged in or related to interstate commerce.

Also, registration and the failure to apply for exemption could be due *entirely* to the consideration that a holding company incorporated in Delaware happens to own more than 10% of the stock of another company (regardless of its nature), doing an entirely local business but incorporated in a State other than Delaware. Certainly, this cannot be deemed to be even a remote indication that the holding company is, or ever was, engaged in, or that it does, or ever did affect, interstate commerce.

If the assumptions properly made from the fact of registration by a holding company and its failure to apply for exemption under the Act are a sufficient basis for action under the Commerce Clause, then Congress could pass a law calling for divestment by any State corporation which has stockholders located in, or which owns stock in subsidiaries incorporated or doing business in, any State other than the State of incorporation of the first corporation. That such a law would be an improper exercise of Congressional power under the commerce clause and violates the Tenth Amendment would seem too clear for argument.

Although from the foregoing it is quite apparent that Congress could not, as Respondent argues (Res. B. 54, footnote 65), "properly apply Section 11 to 'each registered holding company' confident that registration was evidence of the interstate character of that company," Respondent further argues (Res. B. 55) that it was unnecessary for the

Commission to make any finding as to the effect on interstate commerce of the ownership by Engineers of the stock of its subsidiaries, and that such findings "would have been improper since Congress itself had made the necessary findings."

We have already demonstrated that Congress could make no proper *assumptions* as to the interstate nature of Engineers and its engagement in interstate commerce from its registration and failure to apply for exemption. It is quite clear, moreover, that *Congress has made no express findings as to the existence of any relationship on the part of public utility holding companies to interstate commerce.*

If there were any such findings or declarations by Congress in the Act they would be found in Section 1 as all the findings of Congress are contained in that section. Certainly Section 11(b)(1) is no such finding in itself since it is applicable without any reference to interstate commerce.

Section 1(a) of the Act declares that public-utility holding companies and their subsidiaries are affected with a national public interest in certain particulars among others, and then follows five numbered clauses giving the particulars. Clauses (1) and (2) relate to the use by public utility holding companies and their subsidiaries of the mails and instrumentalities of interstate commerce in connection with the sale of securities and service, sales and construction contracts; Clause (3) states that the subsidiary public-utility companies "*often* sell and transport gas and electric energy by the use of means and instrumentalities of interstate commerce"; Clause (4) states that "their practices in respect of and control over subsidiary companies *often* materially affect the interstate commerce in which those companies engage"; and Clause (5) states that their activities extending over many States are not susceptible of effective State control of public utility companies.

Clauses (1) and (2) certainly contain no declaration which would support the constitutionality of Section 11(b)(1) under the Commerce Clause. The fact that com-

panies use the mails and instrumentalities of interstate commerce may make it possible for such use to be regulated as in fact they are with respect to securities by Sections 6 and 7 of the Act, and as they are with respect to service, sales and construction contracts by Section 13 of the Act. But merely because a person uses the mails or instrumentalities of interstate commerce in certain of his transactions does not justify the regulation, control or destruction of his entire business. See *N. L. R. B. v. Santa Cruz Fruit Packing Co.*, 91 F. (2d) 790 (1937); affirmed in *Santa Cruz Fruit Packing Co. v. N. L. R. B.*, 303 U. S. 453 (1938).

With respect to Clauses (3) and (5), the fact that (3) operating public-utility companies “often sell and transport gas and electric energy by the use of means and instrumentalities of interstate commerce”, and (5) that their activities are not susceptible of effective control by the States both seem to be irrelevant in attempting to support the constitutionality of Section 11(b)(1) under the Commerce Clause since that section applies equally to holding companies none of whose subsidiaries sell gas and electricity by use of means and instrumentalities of interstate commerce, and even though the holding company and its subsidiaries do not extend over more than one State and are entirely susceptible to effective State regulation.

With respect to Clause 4, the statement is only that their practices “often materially affect the interstate commerce in which those companies engage”. Certainly this is not a statement that all of such companies are engaged in interstate commerce, or that all of such companies materially affect interstate commerce. The statement is merely that holding company practices in respect of and control over subsidiary companies “often” materially affect interstate commerce. This is a clear implication that they do not always or even generally do so. One would naturally expect before a divestment order under Section 11(b)(1) were entered, that it would be required that a finding relating to interstate commerce must be made in the particular case, but neither in Section 11, nor anywhere

else in the Act, is such a finding required before a divestment order is entered. It would seem clear that a legislative declaration that an effect on interstate commerce sufficient to justify congressional action exists in some cases is not sufficient to support congressional action which applies to all cases without specific findings. If it is within the power of Congress under the Commerce Clause to direct Engineers to divest itself of all save one of its systems because holding companies "*often*" engage in interstate commerce and because some of them have been guilty of abuses, then it would be within the competency of Congress to enact a statute in which all corporations and individuals may be prohibited from owning property in certain cases or in certain locations without any finding that by such ownership interstate commerce is affected substantially or in any way.

Section 1(b) of the Act declares that "the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected" *when* certain conditions exist. These conditions are not related to interstate commerce in any way. In fact the words "interstate commerce" or their equivalent do not appear in Section 1(b) at all and no reference is made to such commerce therein. Moreover, there is no finding that such conditions exist with respect to all or any particular holding companies.

Section 1(c) declares the policy of the Act to be "to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies *which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce * * **" In other words, the policy is to meet the problems and eliminate the evils of companies *which are engaged in interstate activities*. But there is no *finding that all or any such companies are engaged in such activities*.

There is obviously a vital hiatus in the Congressional findings and declarations of policy. Congress has not

declared that public utility holding companies are interstate companies or that their ownership and control of their subsidiaries affect interstate commerce, and the Commission has not so found.

It should be emphasized at this point that this Act does not lend itself to an assumption that it was intended by Congress that the courts should decide the applicability of Section 11(b)(1) upon the basis of an engaging in, or an effect upon, interstate commerce, because the entire mechanics and construction of the Act in effect precludes any court from having before it the basis for any judicial findings on these interstate commerce questions. Section 11(b)(1) proceedings reach the courts only upon review after the making of a record before the Commission and on the record so made. The Commission's jurisdiction is restricted so that, as the Commission itself admits, it has no business making any findings as to interstate commerce and that such findings by it would have been "improper" (Res. B. 54-55).

In Respondent's Brief in support of the statement as to constitutionality of dispensing with specific findings in cases where Congress has found that the activities regulated have a direct bearing on interstate commerce, Respondent relies only on the *Darby* case, *supra*. There is a marked distinction, however, between Section 11(b)(1) of the Act and the Fair Labor Standards Act involved in the *Darby* case. In the Fair Labor Standards Act Congress itself specifically made the finding that substandard wages paid by employers engaged in interstate commerce or producing goods for interstate commerce burdened and obstructed such commerce. This was held to be a proper basis for the exercise of the commerce power. We have shown, however, that there is no such basis even attempted to be laid for Section 11(b)(1); that section does not even purport to be in any respect a regulation of interstate commerce. *It is no more than a rule setting forth the conditions upon which certain types of property may be owned regardless of any connection with interstate commerce.*

It is clear that Section 11(b)(1) must fall as an improper exercise of power under the Commerce Clause and hence a violation of the Tenth Amendment, and that its defects in such connection cannot be remedied by judicial action.

III.

As to the Commission's choice of Virginia as the single system.

In Petitioners' Main Brief (Pet. B., 45-47) the point is made that the Commission's construction of 11(b)(1) as authorizing it to control the choice of one of several eligible integrated systems as the single system is untenable. The ground urged is that Section 11(b)(1) cannot possibly be given such a construction, since there are no standards whatever for the guidance of the Commission in such a choice and under such circumstances, if the power to make such a choice were implied (or even if it were expressly granted, as it is not), Section 11(b)(1) would be unconstitutional and void as an improper delegation of legislative power.

Respondent in its brief does not deny the necessity for legislative standards. Respondent argues, rather, that the Act does contain such standards, and in support of such position says (Res. B. 52, footnote 64):

"The Commission must find that the action it requires is 'necessary to limit the operations of the holding-company system' in accordance with the specific standards of Section 11(b). The standards prescribed by Congress are so clear and definite as to leave no question as to the propriety of the delegation."

Respondent's claim that there is a standard for the guidance of the Commission in a choice of the single system where the Commission finds more than one eligible integrated system, is dissipated entirely when Section 11(b)(1) is analyzed. That section deals with three distinct subject matters:

(a) limitation of the operations of the holding company to a single public utility system;

(b) limitation of "other businesses", that is, businesses other than that of public utilities; and

(c) one or more systems which may be retained in addition to the single system.

When the contents of Section 11(b)(1) are examined for the purpose of determining the question of the presence or absence of congressional standards as to these three subject matters, it will be seen that with respect to (b) above, that is, limitation of "other businesses", the congressional standards are set up in the second other business clause which provides that those businesses may be retained which the Commission "shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems". And so with (c) above, that is, the system which may be retained *in addition* to the single system, the congressional standards are set forth in clause (A), an economic standard, in clause (B), a geographical standard and in clause (C), a size standard.

But when the subject matter relating to (a) above, namely, the limitation to a single public utility system, is examined, it will be seen that there are no standards whatsoever. There is, of course, in Section 2(a)(29) a definition as to what constitutes an integrated public-utility system, which in effect provides that such a system shall be one which is interconnected or capable of being interconnected, located in a single area or region, and of a certain size. There is, however, nowhere in the Act in Section 11(b)(1), or elsewhere, any standard to serve as a guide to the Commission in *choosing* which of several such integrated systems shall be chosen as the single integrated system in a case where, as here, there are several such systems. All there is in this connection is the provision that the Commission "shall take such action as the Commission shall find necessary to limit the operations of the

holding company system of which such company is a part to a single integrated public-utility system”.

This prescribes no standard; it merely directs a result. There is here not one word to fetter the uncontrolled discretion of the Commission in choosing one as between several integrated systems as the single integrated system. Congress did not say to the Commission that it should choose as the single system in such a case that which was the most important operating system or the system with the greatest revenue. Nor indeed was the Commission directed that the most appropriate single system should be chosen from the point of view of the public interest or for the protection of investors or consumers—standards which Congress did apply to the question of what other businesses could be retained. To say, under these circumstances, as Respondent does, in its brief, that there are standards to guide the Commission in designating the single system among one or more integrated systems, is simply untrue.

So far as the choice of a single system out of a number of eligible integrated systems is concerned, the delegation of authority is precisely the kind of delegation held unconstitutional by the Supreme Court in *Panama Refining Co. v. Ryan*, 293 U. S. 388 (1934). In that case, the President was authorized, under Section 9(c) of the National Industrial Recovery Act, to prohibit the transportation in interstate and foreign commerce of oil produced or withdrawn from storage in excess of amounts permitted by State authority. The statute did not prescribe the conditions or standards upon the basis of which the President was authorized to accomplish the stated result—as in Section 11(b)(1) in respect of the choice of the single system, it merely authorized the result. In view of this lack of any standard, to save Section 11(b)(1) from constitutional invalidity, it must be held that the Commission has no authority to choose or control the choice of a single system from among several integrated systems; and obviously, if the Commission has no such authority the choice must be left to the holding company, which can be

accomplished through an alternative order to be complied within the period of time allowed for divestment.

The major portion of Respondent's Brief on this subject is confined to a discussion of the decision of the Circuit Court of Appeals for the Second Circuit in *North American Company v. Securities and Exchange Commission*, 133 F. (2d) 148 (1943). We point out, however, that in that case the Court did no more than support Respondent's erroneous construction of 11(b)(1) and that there was not raised in that case the constitutional point as to delegation of power here relied upon. This point is raised in this case for the first time. Since this point was not made in the *North American* case, the decision of the Circuit Court of Appeals for the Second Circuit approving Respondent's construction is of no weight whatever. Had the fact that there are no legislative standards whatever in Section 11(b)(1) as to the choice of a single system among several eligible integrated systems been called to the attention of that Court, the decision in the *North American* case of necessity would have been otherwise in order to save the constitutionality of the provision under the principle referred to and amply supported by the cases cited at page 47 of Petitioner's Main Brief.

Respondent seeks to justify its choice of Virginia as the single system because, as it says, under Section 11(b)(1) it has the duty to require "as soon as practicable" the limitation of the operation of the holding company systems as prescribed in that section (Res. B. 49). This provision obviously has to do only with the time when the Commission should enter the divestment orders and is not a standard. A standard must prescribe the conditions under which the action is to be taken and to say that the action shall be taken "as soon as practicable" certainly prescribes no standard. Congress evidently intended that the Commission should not unduly delay the entry of such divestment orders but this had nothing to do with the time for compliance; this was provided for in Section 11(c) of the Act.

Respondent argues that Petitioners' insistence upon further time to elect as between Gulf and Virginia is made

purely for strategic purposes (Res. B. 52, footnote 63). As a basis for this argument Respondent states that Petitioners have represented to the Commission that the provisions of the Federal income tax law permitting the filing of consolidated returns result in substantial tax savings through the filing of a consolidated income tax return by Virginia and Engineers, and they then point out that Engineers' interest in Gulf is not sufficient to permit the filing of a consolidated income tax return. The only reason why Engineers and Gulf cannot file a consolidated income tax return and thus make substantial savings in income taxes is because the outstanding preferred stock of Gulf has voting power. All that need to be done to remedy this situation and get the requisite control of Gulf to enable the filing of consolidated returns would be to refund Gulf preferred stock with nonvoting securities (Res. App., p. 3).

Since the Petitioners have, under Section 11(b)(1), properly construed, the right to make the selection as between Gulf and Virginia at any time prior to the expiration of the one-year period prescribed in the divestment order of its single retainable system, it is premature for the Respondent to suggest that Petitioners have not claimed that the choice of Virginia as the single system was a wrong choice. Nobody knows until the expiration of the period within which Petitioners have the right to make such selection whether it is a wrong choice or not as so many conditions beyond the control of either the Petitioners or the Commission may influence the ultimate decision.

The Commission in this case having, without authority, undertaken itself to control the choice of the single system within a wholly arbitrary period of time nowhere authorized in the Act, the order must be set aside.

IV.

As to the construction of Big B of Section 11(b)(1).

When there is disregarded the speech of Senator Wheeler for the reason that it was delivered after the passage of the Act and, therefore, could have had no effect on congressional intent (Res. B. 15-16), the Respondent, as justification for substantially re-writing Big B, relies almost entirely on the Conference Report from which it quotes extensively (Res. B. 13). In making such quotation, Respondent places italic-emphasis on only one paragraph of the Conference Report. It may reasonably be presumed it does so because it believes the emphasized paragraph lends the most support to its one-area interpretation. Accordingly, that paragraph is worthy of analysis. It is quoted below carrying Respondent's emphasis:

"The substitute, therefore, makes provision to meet the situation where a holding company can show a real economic need on the part of additional integrated systems for permitting the holding company *to keep these additional systems under localized management with a principal integrated system. Under such circumstances the Commission is directed to permit the holding company to retain control of such additional systems, even though not physically integrated with the principal system, provided all such integrated systems are located in the the same State or States, or in adjoining States or a contiguous foreign country.*"

When this paragraph of the Conference Report is analyzed, it becomes apparent that it affords no justification for interpolating into Big B the words "in which the single integrated public-utility system operates." (see Pet. B. 49).

As a basis for such a radical change in a law through construction based on legislative history, one would expect to find in that history a clear statement justifying the change. The above quoted paragraph from the Conference

Report, principally relied upon by the Respondent, not only is not such a clear statement but on the contrary, on a natural construction of its language, it is just as consistent with the two-area interpretation as it is with the one-area interpretation.

The paragraph re-written with interpolations in brackets indicating its natural meaning is as follows:

“The substitute, therefore, makes provisions to meet the situation where a holding company can show a real economic need on the part of additional integrated systems [that is, which meet the economic test contained in Clause (A) of Section 11(b)(1)] for permitting the holding company to keep these additional systems under localized management [evidently an elliptical statement of the words ‘*advantages of localized management*’ as contained in Clause (C) of Section 11(b)(1) and a very different concept from ‘localized management’] with a principal integrated system. Under such circumstances the Commission is directed to permit the holding company to retain control of such additional systems, even though not physically integrated with the principal system, provided all such [additional] integrated systems [that is those systems which meet the economic test contained in Clause (A) even though not physically integrated with the principal system], are located in the same State or States or in adjoining States or a contiguous foreign country.”

Not one word is contained in this paragraph which indicates that the additional systems to be retained must be located in the same State “in which the single integrated public-utility system operates”. Everything contained in this paragraph is entirely consistent with their geographical location elsewhere; and yet, acting principally on this item of legislative history, the Respondent undertakes to read the quoted phrase into Big B, thus entirely changing its clear and natural meaning.

Then the Respondent turns to the recital of one of the evils in Section 1(b)(4) for internal evidence in the Act which, as it says, leads to a one-area interpretation of Big

B (Res. B. 16). This recital is quoted below carrying the Respondent's emphasis:

“* * * when the growth and extension of holding companies bears no relation to economy of management and operation *or the integration and coordination of related operating properties—*”

This language, says Respondent in effect, shows that the additional system, to qualify for retention with the principal system, must be located close to the principal system. Here again the portion of the language emphasized is just as consistent with the two-area interpretation as it is with the one-area interpretation. On the one-area interpretation, admittedly the additional systems (though they must be in the same State as the principal system) are not to be integrated or co-ordinated with the principal system. This must be so, because, if they were, they would become part of the integrated system itself under the definition of an integrated system contained in Section 2(a)(29) of the Act. So with the two-area interpretation. Here also they are not integrated or co-ordinated with the principal system but on this interpretation may be in any State or States adjoining that State regardless of the location of the principal system. On the crucial point of the location of the principal system with reference to such additional systems, the quoted clause is colorless. It does not say that the “operating properties” must be “related” in any geographic way, or that any such geographic way must be one of position. The “relation” might quite as well be determined by investment considerations. It is entirely consistent with both the one-area and the two-area constructions.

As to the absurd result which the Respondent says follow from the two-area interpretation, namely, that if Engineers retains Gulf with Virginia, it cannot also retain the Virginia gas system (Res. B. 19), Petitioners point out in their Main Brief that Section 11(b)(1) was supposed to have been a compromise between two extreme positions

and compromises do not necessarily lead to logical results. In this instance, however, there is nothing illogical in Engineers' position. The Act gives Engineers the choice of the single system and of the additional system or systems provided the A B C Standards are satisfied; and this is true whether the additional systems be far from or near to the single system. It is logical to choose Gulf rather than Virginia gas as the additional system, as Gulf is plainly the more profitable system. In fact, Petitioners point out in their Main Brief very absurd results which follow from the one-area interpretation also (Pet. B. 58).

When the words of Big B are given their natural meaning, they lead to a two-area construction. There is nothing in the legislative history or internally in the Act which justifies to any extent reading into Big B the phrase "in which the single integrated public-utility system operates." So to do is to indulge in judicial legislation. Big B should be given a two-area construction.

V.

As to the Virginia Gas System.

1. The Commission did not properly apply Clause (A) of Section 11(b)(1).

Instead of applying the A standard according to its plain meaning to permit the continued combination of the Virginia gas system as an additional system with the Virginia electric system if "substantial economies" were shown to exist which would be lost if the gas system were independently operated, Respondent has, by interpretation of the statute, added the further requirement that, in order for the Virginia gas system to qualify for retention under Clause (A), it must be shown to be "so small (as to be) incapable of independent economical operation" and must have "a real economic need" for retention (Res. B. 24). Respondent here erroneously relies on two ill considered

phrases in the so-called legislative history; one from the Conference Report, and the other from Senator Wheeler's posthumous speech.*

The statute plainly contemplates that the important consideration is not any "economic need on the part of additional integrated systems" or whether or not the additional systems are "so small that they were incapable of independent economical operation" but solely whether or not each additional system "cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system".

Of course, if there is reasonable doubt shown by the record as to whether "economy is achieved by centralized control" in the particular case, the Court cannot review or reweigh the evidence, as was said by the Court in *The*

* The language relied on in the Conference Report is that the compromise substitute as set forth in the A-B-C standards makes provision for the retention of additional systems "where a holding company can show a *real economic need* on the part of additional integrated systems for permitting the holding company to keep these additional systems * * *". The comment relied on in Senator Wheeler's speech was to the effect that the Senate conferees concluded that the furthest concession they could make would be to permit the Commission to allow a holding company to control more than one integrated system if the additional systems were in the same region as the principal system and were "*so small that they were incapable of independent economical operation*" (Res. B. 23-24).

No real aid can be obtained by reference to either of the above phrases. Both show confused thought. Section 2(a) (29) defines an "integrated public-utility system" as one "which under normal conditions may be *economically* operated as a single interconnected and coordinated system * * *". As all integrated systems must conform to this definition before their retention as additional systems becomes an issue, there can never be a *real economic need* on the part of an additional integrated system that it be retained in combination with a principal system. The only real economic need which can require the combination of one or more public utility operating companies, each capable under normal conditions of economical operation, is the need in the public interest or for the protection of investors or consumers that advantage be taken of *substantial economies* which can be realized from joint operation of the combination of systems. The plain meaning of the language of the A standard is that the Commission shall permit the combination where there are such substantial economies.

The comment in Senator Wheeler's speech is even more confused than that in the Conference Report. When he stated one condition for retainability to be that each such additional system must be "*incapable of independent economical operation*", this was on its face contrary to the requirement of Section 2(a) (29) and thus was unintelligible.

North American Company case, *supra*.^{*} This principle has no application where the Commission's finding that no loss of substantial economies has been shown is contrary to uncontroverted evidence and is without substantial evidence to support it, as Section 24 of the Act provides that in order for the Commission's finding of fact to be conclusive it must be supported by substantial evidence. Substantial evidence to support any conclusive finding of the Commission under Clause (A) must be "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion". *Consolidated Edison Co. v. N. L. R. B.*, 305 U. S. 197, 229 (1938). Nothing said by the Second Circuit Court of Appeals in the *North American* case or in *Morgan Stanley Co. v. Securities and Exchange Commission*, 126 F. (2d) 325 (1942), was intended to support a contrary view; otherwise the requirement in Section 24 of the Act that the Commission's findings of fact should be conclusive only if supported by substantial evidence would be nullified.

The basic misconception of the Commission as to the true meaning of Clause (A) is well illustrated by the Commission's decision to permit the retention by the El Paso Company of the electric utility system in the small town of Van Horn, Texas, located 40 miles from the main El Paso electric system (Pet. App. 145-146). The small system in Van Horn served only about 200 customers and was isolated. This system *alone*, of all the seven additional electric and gas systems claimed by Petitioners to be retainable with Virginia or Gulf, the Commission permitted to be retained. We submit that the Commission clearly was not authorized to engraft on the Act the additional requirement applied in its opinion.

^{*} It will be noted that the two additional systems, Cleveland and Wisconsin, claimed by the holding company in that case to be retainable with the St. Louis system, were very large systems and, therefore, did not lend themselves readily to a showing of substantial economies by joint operation. Further, the economies claimed were only of a general character "to furnish financial advice and, on occasions, direct financial assistance to its subsidiaries, and to sponsor the interchange of statistical and operating information among them" (133 Fed. (2d) 148, at 152).

2. **The Commission's conclusion that the Virginia gas system can be operated as an independent system without the loss of substantial economies, which can be secured by the retention of that system in combination with the electric system, is not supported by any substantial evidence.**

A brief review of the contentions in the respective briefs will now serve to show the Court just how narrow is the issue of fact before the Court and will demonstrate how plainly the Commission has deviated from the Clause (A) standard in weighing the substantiality of the economies which can be secured by the retention of the Virginia gas system in combination with the electric system.

(a) Unquestioned Economies.

The outstanding fact now disclosed is that the Respondent does not question Petitioners' contention that the unified operation has been shown by the evidence to reduce operating expenses by an amount of approximately \$91,000, of which \$35,000 is allocable to the gas operations and \$56,000 to the other operations. These are the *minimum* economies which the Court must now consider as established beyond question by the record, unless the Court concludes that these amounts should be reduced because of the so-called "countervailing advantages" claimed by Respondent but not supported by any evidence.

The only argument aimed at minimizing the substantial nature of the \$56,000 savings to Virginia's electric system is the comment (Res. B. 26) "This is equivalent to but $\frac{3}{5}$ of 1 per cent of the electric system's operating expense, including taxes and depreciation for 1940". Taxes and depreciation should not be included in the electric system's operating expenses and with these items excluded the percentage is about 1 per cent. However, viewed in another way, this \$56,000 is equivalent to approximately 42% of the total executive salaries of the 17 executives of Virginia, parts of whose salaries were charged to the gas department for 1940 (Pet. App. 851).

Respondent recognizes (Res. B. 31) that increased operating expense to the independent gas system in the amount of \$35,000 (about one-half that claimed) has possibly been shown and that this is equivalent to a 4.7% increase in the total gas operating expenses for 1940. Indeed the Commission so found (Pet. App. 105), adding in a footnote that this was the equivalent of a decrease of 13.3% in gross gas income for 1940 and a decrease of 29.8% in the 1940 gas income available for dividends.

We submit that these unquestioned economies plainly satisfy the A standard and that the Commission's failure so to find can be explained only on the theory that it has misconceived its duty and the plain meaning of the language in the statute.

The Commission also recognized in its Findings and Opinion (Pet. App. 103) that the economies (\$71,500)* claimed by Petitioners allocable to the gas operations, "if accurate and in the absence of any benefits resulting from separation, afford an *impressive basis* for finding a loss of substantial economies". Hence, the controlling issue of fact before the Court is as to the propriety of the Commission's finding of no substantial economies: first, on the basis of the unquestioned economies; and, second, on the basis of the additional economies, questioned but proved by the record.

Respondent argues that, as utility representatives contended before Congressional committees that certain savings could be expected to result from joint operation of utility systems, Congress must have intended that "such expenses as customarily arise on severance of joint operations are not truly lost economies" (Res. B. 26). This is clearly unsound. In the ordinary joint electric-gas operation the loss of economies involved necessarily occurs on severance. The dollar amounts and proportions of such lost economies will, of course, vary from case to case. Congress concluded, as stated by Respondent, that it "pre-

* The comparable figure on Eng. Ex. 223 (Pet. App. 859) and Eng. Ex. 224 (Pet. App. 863) is \$75,130, but this figure was adjusted to \$71,522 as explained in footnote (Pet. App. 331-332).

ferred the Commission to handle the problem on a case-to-case basis" (Res. B. 26). The Court in *The North American* case, *supra*, in agreeing with the Commission's ruling, stated "'substantial economies' means important economies and not merely something more than nominal". By this test, the ultimate question in each situation is whether or not the economies which would be lost by severance have been shown to be "important" or "more than nominal". But in applying this test, the amounts involved must be related to the expenses and profits of the system or systems in question. If the Commission is to be permitted, without any substantial evidence in support thereof, to offset proved substantial economies by so-called "countervailing advantages", claimed to arise by assumed speculative increased income which *might* result from severance or from assumed other intangible advantages which *might or might not* be secured from a separate staff with undivided loyalty to the conduct of the gas business, then in effect the A standard prescribed by Congress may be nullified in every case. In fact the standard as a rule of law completely disappears.

Merely because the Commission functions as an expert administrative agency in its consideration of the evidence, in no wise affects the rule prescribed by the statute that the Commission's findings must be based on substantial evidence. As stated by the Court in *Appalachian Electric P. Co. v. N. L. R. B.*, 93 F. (2d) 985 (1938) in setting aside an order of the Labor Board the Court said (p. 989):

"We are bound by the Board's findings of fact as to matters within its jurisdiction, where the findings are supported by substantial evidence; but we are not bound by findings which are not so supported. (Citing statute and cases.) The rule as to substantiality is not different, we think, from that to be applied in reviewing the refusal to direct a verdict at law, where the lack of substantial evidence is the test of the right to a directed verdict. In either case, *substantial evidence is evidence furnishing a substantial basis of fact from which the fact in issue can reasonably be inferred*; and the test is not sat-

isfied by evidence which merely creates a suspicion or which amounts to no more than a scintilla or which gives equal support to inconsistent inferences.”

There is nothing about “substantial economies” which is peculiarly beyond the competency of the reviewing court to judge; indeed the issue is nowhere near so complicated as many questions in valuation for rate making and other purposes which the courts are frequently called upon to review. Viewed in like manner, we submit that \$91,000 of unquestioned savings by joint operation clearly entitled Petitioners, as a matter of law, to a finding that the A Standard had been satisfied.

(b) Additional Economies.

Respondent next argues that Petitioners’ estimate of increased expense attributed to the gas system on divestment is disproportionately high and that the Commission properly eliminated the excessive amounts. This contention is made with respect to Petitioners’ estimate of increased expense falling on independent gas operation in connection with three items: (i) customers accounting and collection expense, (ii) general and administrative expense and (iii) sales promotion expense. We turn now to these three questioned items.

Customers Accounting and Collection:

It is argued that Petitioners’ estimate of \$18,592* of increased expense on account of customers accounting and collection is disproportionately high (Res. B. 27).

The only comment with respect to this item in the Commission’s decision (Pet. App. 104) is: “For instance, the evidence introduced in these proceedings requires a significant reduction of respondent’s estimate that independent operations will require 19 additional employees for conducting the ‘customers accounting and collection’ work.

* This is the total estimated increased Customers Accounting and Collection cost to the gas department if operated as a separate company, \$22,000 (Eng. Ex. 221, Pet. App. 847) adjusted as explained Pet. App. 331-332 and footnote.

Nor does the record sustain a claimed cost of performing billing and accounting operations for the independent gas company alone which is almost identical with the present cost of these operations for combined gas and electric customers."

Respondent then undertakes to elaborate on the finding on this point by contending that "Petitioners' witness admitted that some of the employees alleged to be necessary could in fact be dispensed with"; reference is made to the fact that the estimates for the items of billing and accounting work for gas customers alone were more than the present cost for billing the same customers for both gas and electricity; and the method presently employed by Petitioners in allocating the salaries for such work now performed jointly for the gas and electric systems is commented on. No support is to be found in the record for any material reduction of Petitioners' estimates on these items (Res. B. 27-28).*

* The witness Mitchell testified that Eng. Ex. 221 (Pet. App. 847), which showed the personnel required to handle customers accounting and collection work for independent gas operation, including 3 cashiers, was prepared by the witness Throckmorton and himself jointly after a thorough study of the situation (R., p. 4034), and instead of stating that only two cashiers would be required he testified "I do not think you can do it with *less* than two," and then added "an independent company would require, I should say, *two or three* cashiers to do the work in connection with collecting customers' accounts and the clerical work that is strictly connected with the cashiers' work" (R., p. 4028-4029; Resp. App. p. 14). When the Trial Examiner permitted the witness to refresh his recollection by referring to his working papers he reaffirmed the correctness of the estimate of 3 cashiers as shown on Eng. Ex. 221 (R., pp. 4039-4042). In any event the estimated salary of the one cashier in question was only \$1,500 (Pet. App. 848).

As to the contention that Respondents' witness admitted on cross examination that both the credit manager and supervisor of customers' accounting and collecting might be consolidated into one position no reference is made to the fact which this witness pointed out that if such consolidation were made "... you would have to get a much higher priced man" (R., p. 4065). The total annual salary allowed in Respondent's estimate (Eng. Ex. 221) for both the accounting supervisor and credit manager of the independent gas company was only \$4,500, a very conservative amount to be paid for one employee qualified to handle both jobs. In any event if the credit manager were eliminated this would reduce the estimate by only \$2,100 (Pet. App. 848).

As to the present method of allocating this expense, the Virginia Company had approximately 205,000 customers in 1940 as compared with approximately 29,000 customers which the independent gas company would have (R., pp. 4138-39). The present charge for customers' billing and accounting applicable to the combination gas and electric customers was \$19,400, one-half of which, \$9,700, was charged to the electric department expense and like amount to gas department expense (Eng. Ex. 221, Pet. App. 847). This item of \$9,700 presently charged to the gas department is a weighted figure, which, when adjusted

Administrative and General Expense

Respondent argues that Petitioners' estimate of increased expense for general and administrative expenses in the amount of \$45,130 (Eng. Ex. 223, Pet. App. 859) for the independent gas operation, was shown to be excessive and the Commission was accordingly justified in reducing this amount by an unstated sum (Res. B. 28-29).

It is significant that the Commission in its Findings and Opinion (Pet. App. 104-5) made no finding that this estimate was to any extent excessive.*

Despite the discrepancy in approach, Respondent now contends that an item of \$16,360** included in Petitioners'

so as to eliminate the weighting (that is, by adding thereto one-third thereof) amounts to \$12,933, so that the true comparison is between \$12,933 on an unweighted basis and the estimate of \$19,800 representing the cost to the independent gas company in connection with this account. As the witness Mitchell pointed out the difference is accounted for by reason of the economies which obviously arise from the larger size of the Virginia Company as compared with the smaller independent gas company (R., p. 4075).

Mr. Throckmorton testified that the new organization planned for the independent gas company was not made with a view to making an absolute comparison with the expense presently allocable to the gas department. He said "I made no comparison and we set up an independent organization and that was the cost of operating an independent company . . . We set up an organization with all the experience that the department heads and the executives have had, and we set up an organization that we thought would provide the same type of service now being provided . . . We did not use imagination, we had experience" (R., p. 4124). It was never shown that there was no need for any particular employee among the 34 required as indicated on Eng. Ex. 221. In view of this clear and uncontroverted evidence the argument by Respondent that a rule of thumb method might appropriately be applied by the Commission to determine a proper cost for customers' accounting and collecting expense for the independent gas company by arbitrarily increasing the present \$9,700 allocated expense to the gas department by one-third, that is, to the extent of \$3,233, is wholly unwarranted, because the only way to determine the actual cost of operating such an organization is to determine how many employees are needed and what attendant expenses are necessarily involved. This is the approach, based upon actual experience, which Respondents' witnesses took, as compared with the arbitrary method which Respondent now suggests.

* The gist of the finding on this point was: "The record discloses that the present executives of Virginia devote no more than 6 per cent of their time to the problems of the gas operations. Respondents estimate an increase of \$11,500 in salaries of general officers and executives who will be needed if the gas properties are to be operated independently" (Pet. App. 104-105). On these premises the Commission simply expressed the view "Presumably, the additional assistance will be competent," and that it was proper to *presuppose* that the services of the new personnel will be worth the additional expense.

** This item appears as \$24,000 under "Management and Supervision Fees and Expenses" in Schedule B, Eng. Ex. 223 (Pet. App. 861) subject to a credit there noted and Respondent has made a deduction of \$7,640 therefrom which Petitioners' witness Barnes explained and contended should not be deducted (Pet. App. 601-602).

estimate of general and administrative expense for the independent gas operation, representing the amount necessary to be paid an outside servicing organization to perform certain essential supervisory and other technical services* for the independent gas system, should be eliminated as few gas companies at the present time regard such outside services as necessary and since it should be assumed that if competent officers were obtained no such outside services would be needed. The evidence shows beyond question that the executive and technical staffs of the independent gas company were not assumed to have the experience and technical background required for the proper performance by them of all of the duties required for the efficient operation of the independent gas company. Petitioners' estimate of necessary general and administrative expenses for the independent gas company presupposed that that company would obtain all necessary executive, supervisory and technical services on the most economical basis possible. As shown by the evidence this assumes that certain supervisory and technical services be obtained from an outside servicing organization; if this had not been the case it would have been necessary to strengthen the executive and technical staff of the independent gas company at greater cost than the amount required to be paid to an outside organization** (Res. App. 1-2, 4-8; also Engineers Ex. 229; Pet. App. 585-586, 590; Res. App. 57-63).

With respect to the item of \$11,500 included in Petitioners' estimate of \$23,000 a year for salaries of general officers and executives for the independent gas company (Pet. App. 861), while it is true that Petitioners' estimate is exactly twice the amount presently allocated to the gas

* Eng. Ex. 229 (Res. App. 57-63) is a tabulation of the more important specific services rendered by such a servicing organization, such as advice regarding financing, capital additions and retirements, taxation, rate structures, dealings with governmental and regulatory bodies, etc.

** Thus the fact pointed out by Respondent that numerous gas systems in the country (contrary to the practice in the electric industry) do not maintain servicing arrangements with outside service organizations becomes immaterial (Res. B. 28). The significant fact is that the over-all estimate for administrative and general expense for the independent gas company, as shown on Eng. Ex. 223 (Pet. App. 858), is substantially lower than the similar costs of Portsmouth Gas Company (located just across the Elizabeth River from the Virginia gas system) and Roanoke Gas Light Company at Roanoke, Virginia, the two gas systems in Virginia most similar to the Virginia gas system (Pet. B. 93).

system, there is no claim made that the size of the staff proposed (Eng. Ex. 223, Schedule B-1, Pet. App. 862) is more than is required. Obviously the four officers and the salaries proposed are about the minimum for a gas system of this size, with assets of about \$6,000,000 and a gross income of over \$1,000,000 (Pet. App. 327-328). It is suggested that "the gas system is presently operated by one man,"* Mr. Brooks, present manager of the gas department, and mention is made of the fact that the general executives devote only about 5 per cent of their time to the gas operation. The evidence shows that Mr. Brooks does not in any sense function as the chief executive officer of the independent gas company would be required to function. Rather he is concerned with the daily routine of merely manufacturing and distributing gas. The real executive problems of the gas department, such as financing, capital additions and retirements, taxation, rate structures, dealings with governmental and regulatory bodies, etc., are dealt with by the executives in higher authority and by representatives of the servicing organization (Res. App. 1-2, 4-8, 34; see also R., pp. 4938-4939). The evidence shows beyond question that the Virginia gas system is being economically and efficiently operated** with a thoroughly competent staff at the present time (Pet. App. 328-334); so that the argument that the Commission had the right to assume that another group of officers working solely for the independent gas system could be expected to render a service having a value greater than that rendered by the present officers and staff so as to offset the necessary increased expenses, is purely speculative and without the slightest foundation in the evidence.

Sales Promotion Expense:

Respondent questions Petitioners' estimate of increased sales promotion expense in connection with independent gas

* Respondent argues that, in the light of this situation "the doubling of the gas property's executive compensation for this purpose appeared to the Commission to be excessive" (Res. B. 29). As above shown, the Commission made no such finding.

**This was also implicit in the Commission's finding that the Virginia gas system satisfied the Section 2(a) (29) standard for an "integrated public utility system" (Pet. App. 99).

operation in the amount of \$7,800, claiming that \$5,300 of this amount attributed to setting up a sales staff is not supported by the record and that an increase of \$2,500 in expense (erroneously referred to as \$3,500, Res. B. 30) for increased advertising expense is contradicted by Petitioners' own witness. Respondent is in error on both of these points.*

Respondent concludes the argument on this issue by contending that there are three countervailing advantages of independent operation which the Commission had the right to consider. The first is that the Commission properly took into account the economic advantages which would result from placing the gas and electric businesses in Norfolk on a truly competitive basis (Res. B. 32). As pointed out in Petitioners' Main Brief (Pet. B. 88) this question is beyond the Commission's authority, as Congress has determined the public policy involved permitting the joint operation without leaving any discretion to the Commission here. Besides, the evidence shows the gas business to have been vigorously promoted and efficiently operated without any trace of adverse effect because of joint ownership with the electric system (Pet. App. 566-576).

The second is that the Commission properly took into consideration the advantages to be obtained by a staff solely devoted to operating the gas system. Here Respondent speculates contrary to the uncontroverted evidence as to the economy and efficiency of the present operation.

* As to the \$5,300 item (Eng. Ex. 223, Pet. App. 859-860), the estimate covers solely the increased expense in setting up the necessary sales promotion staff. Without any evidence to support it, the argument of the Respondent is that the independent gas company would not actually employ a sales manager but that one of the sales engineers would function also in that capacity. This is mere speculation, as contrasted with the considered judgment of Petitioners' witnesses who studied the problem with their staff (Pet. App. 579-590).

With respect to the other item of \$2,500 additional expense for advertising for the independent gas company, Respondent relies entirely upon the statement of the witness, Throckmorton, to the effect that Petitioners' estimate of \$3,600 for advertising for the independent gas company included the advertising of appliances as well as institutional advertising. The record shows that the witness was confused at the time he made this statement and that it was promptly cleared up in the record (Pet. App. 588-589 and Eng. Ex. 221; Res. App. 31-34). The fact was as stated by the witness Holtzclaw, through whose testimony Engineers Exhibit 221 was introduced, that the \$3,600 did not include anything for appliance advertising (Pet. App. 589).

The third is that joint operation has resulted in certain improper allocations of expense between the gas and electric properties in the past. The evidence shows that there had been no occasion for critical analysis of such allocations until this proceeding was begun (Pet. App. 461-473). Proper allocation of such expenses, based upon a scientific study made by independent accountants during the course of this proceeding, are being made and there is ample regulatory authority to assure proper allocations in the future.*

Summary:

On the basis of the unquestioned economies, and *a fortiori* on the basis of the additional economies clearly established, which the evidence shows will be lost if Virginia is required to divest itself of its gas system and which can be retained by unified operation, it is respectfully submitted that the divestment order with respect to the Virginia gas properties (and their incidental appliance and merchandise business) is not supported by any substantial evidence and should, therefore, be set aside.

VI.

The Commission erroneously ordered the divestment of Virginia's transportation properties and El Paso transportation and toll bridge properties.

1. As to the construction of the "other business" clauses of Section 11(b)(1).

The Petitioners in their Main Brief traced the origin of the second other business clause directly to Section 8(a) of the original Bill S. 1725 (74 Cong. 1st Sess.). In order that this source would clearly appear, Petitioners (Pet. B. 70) set the second other business clause as it finally was

* As to the suggestion that separate operations may result in economies in avoiding the accounting cost of making allocations in the future, see footnote, Pet. B. 89.

As to the overall reasonableness of Petitioners' estimates for all three questioned items, Customers Accounting and Collecting Expense, Administrative and General Expense, and Sales Promotion Expense, see Pet. B. 93, R., p. 10,929.

reported to Congress by the Conference Committee and as it was finally enacted in a parallel column with Section 8(a)(3) of S. 1725. The parallelism is too striking to permit of any explanation except the one made by the Petitioners, namely, that the second other business clause derives directly from Section 8(a)(3) of S. 1725.

Under these circumstances the interpretative memorandum which accompanied S. 1725 on its introduction in Congress would seem from a legislative history point of view to be of overwhelming importance on the question of its interpretation. The explanation of Section 8(a) as it appeared in this interpretative memorandum is set forth in Petitioners' Main Brief (Pet. B. 64) and contained the following:

"It is expressly provided in this subsection, however, that such additional public utility business as an operating company is permitted to carry on by the State in which it is organized shall be allowed to continue. *There is further a flexible provision giving the Commission power to include other incidental activities. These provisions are so designed as not to cause interference with State policy which allows or fosters the carrying on of waterworks, traction business, bus systems, etc. by electric and gas utilities.*" (Emphasis supplied.)

This shows what the sponsors of the Act intended to be the practical effect of the second other business clause; and there is nothing in either the Conference Report or in any of the legislative history summarized in Petitioners' Main Brief to indicate any change in this objective.

When this interpretative memorandum explaining Section 8(a) of S. 1725 is read in the light of the provisions contained in Section 8(a) (which section is set forth in full Pet. B. 64), the unitalicized portion of the above quotation clearly refers to Section 8(a)(2) while the reference in the italicized portion to "a further a flexible provision", is a clear reference to Section 8(a)(3).

The conclusion is inescapable that when Congress used language almost identical with that of Section 8(a)(3) of

S. 1725, it attributed to those words the meaning given to them in the interpretative memorandum which accompanied the original Bill, that is to say, it gave to those words the design expressly stated in the interpretative memorandum, namely :

“not to cause interference with State policy which allows or fosters the carrying on of waterworks, traction business, bus systems, etc. by electric and gas utilities.”

The attempt by the Respondent in footnote 50 (Res. B. 41, footnote 50) to minimize the effect of the interpretative memorandum by pointing out that as the second other business clause was finally enacted on the basis of the Conference Report, Section 8(a)(2) was omitted so that “the language of Section 8(a)(3) was placed in juxtaposition with a test of relationship to electric and gas operations alone”, fails palpably for two reasons: First, the relationship to electric and gas operations existed even in the original S. 1725 (see Section 8(a)(1)). Accordingly, then, that juxtaposition introduced nothing new. Second, the sentence in the interpretative memorandum “there is further a flexible provision giving the Commission power to include other incidental activities” obviously could have no reference to anything in the original Section 8(a) except to Section 8(a)(3). That was the only flexible provision contained in the original Section 8(a). Accordingly, the language in the interpretative memorandum, that “These provisions are so designed as not to cause interference with State policy which allows or fosters the carrying on of waterworks, traction business, bus systems, etc. by electric and gas utilities” obviously must have included reference to Section 8(a)(3) as well as the section subsequently struck out, namely, Section 8(a)(2).

As Petitioners state in their Main Brief (Pet. B. 63-73), it cannot be said, in the light of this interpretative memorandum, that any functional (or as Respondent prefers to call it, operational) relationship need exist between the incidental business which could be retained and the electric or gas utility systems.

There can be no question, therefore, but that Congress intended, as the plain language of the second other incidental business clause clearly shows, that other businesses were to be retainable, that is, they would pass the test of being "reasonably incidental or economically appropriate", if the Commission should find that their retention was necessary or appropriate (i) in the public interest, *or* (ii) for the protection of investors, *or* (iii) for the protection of consumers, *and* (iv) not detrimental to the proper functioning of such system or systems.

The application by the Commission to the other businesses involved in this case of a construction of the other business clauses which required a functional relationship to be shown as a basis for retention was plain error and requires the remanding of the case to the Commission to re-try the other business issues on the basis of a correct interpretation of the other business clauses.

2. The Commission Erroneously Disregarded the Uncontroverted Evidence as to the Retainability of the Transportation and Toll Bridge Businesses.

Respondent begins the discussion of this issue with the statement "The absence of any relationship between the Virginia transportation and El Paso transportation and toll bridge businesses, on the one hand, and the respective electric utility systems, on the other, was explicitly admitted by petitioners' witnesses" (Res. B. 43). This is misleading. Only in the sense of the narrow functionalistic standard now claimed by Respondent to be controlling, is this true.*

* For example, it is not claimed that the Virginia transportation business is tied in with the electric business to the degree that the ice equipment at Williamsburg, Virginia is related to the electric facilities there, the same equipment being used to heat the electric building in winter and cool the building in summer and make ice as a by-product.

As we have shown in Petitioners' Main Brief (Pet. B. 74-79), these other businesses now have and for thirty years have had a close operating relationship to the respective electric businesses. These electric businesses are truly the outgrowth of the early street railway businesses in which electric power was the source of energy for the cars and the surplus electric energy was sold to the public; the joint operation has at all times been sanctioned by State and local

Respondent urges that the three following considerations are irrelevant, which Petitioners contend are pertinent in the determination of the question as to whether or not these businesses satisfy the statutory standard as set out in the two "other business" clauses.

Historical Relationship:

Although Respondent now contends that the admitted historical relationship between the transportation and toll bridge businesses and the respective electric systems is irrelevant, it is significant that the Commission has not always so construed the two other business clauses of Section 11(b)(1).*

The Commission has simply changed its interpretation of the other business clauses in its two recent decisions in *The North American case, supra***, and in the instant case, thus depriving The North American Company and Petitioners of the privilege of retaining with their respective electric systems the same kind of transportation businesses which American Water Works & Electric Company was permitted to retain under no more favorable conditions.

public authorities; there is presently a joint use of personnel and property and consequent unquestioned economies from joint operation; and these other businesses are operating at a profit, and thus are not a burden on the electric businesses; all of which clearly satisfy the relationship contemplated by the statute. The Commission is in effect proposing to engraft on the statute a narrow functionalistic standard not provided for in the Act itself.

* As pointed out in Petitioners' Main Brief (Pet. B. 85), *In the Matter of American Water Works and Electric Co., Inc.* 1937, 2 S. E. C., 972, 984, the Commission, in permitting the retention of street car and bus operations incidental to the holding company's electric systems relied heavily on the historical relationship between the two businesses, stating that the transportation operations were "in the nature of an inheritance from an earlier age", that the bus operations were necessary "to obtain permission to abandon certain electric transportation lines", and that there would be "difficulty * * * in satisfactorily disposing of its interests in these transportation businesses."

** In *The North American case, supra*, the Court in affirming the Commission's ruling said, "It is apparently not disputed that the three other businesses are *unrelated* to the operations of the St. Louis system. Consequently no error appears in ordering their divestment". One of these was a coal business, another was a small investment business and the third was local transportation business far removed from the operations of the retainable St. Louis system. This certainly presented a less favorable situation than Petitioners' case.

Not a word of comment appears in Respondent's Brief undertaking to reconcile this inconsistency.

In the light of this background and in view of the statutory standard for retention, which is merely that the other businesses be "reasonably incidental, or economically . . . appropriate to the operations of one or more integrated public utility systems", and that such other businesses be "appropriate in the public interest . . . and not detrimental to the proper functioning of such system or systems", we submit that clearly the long continued historical relationship is relevant in determining the propriety of the retention of such other businesses.

Economies

Respondent contends that the Petitioners' estimate of increased operating expenses of the electric departments which would result from divestment of the transportation and toll bridge businesses were found by the Commission to be excessive; the estimates (before income tax savings) in the case of Virginia being \$249,000* a year, and in the case of El Paso \$29,000** a year.

Respondent contends that Petitioners claim that additional compensation will have to be paid to electric employees in lieu of their present free transportation privileges is not supported by the record. Respondent here is clearly in error on the facts.***

* Eng. Ex. 128, Pet. App. 795 and Eng. Ex. 228, Pet. App. 881, adjusted as shown in Exhibit A to Petitioners' Brief before the Commission of March 16, 1942 (R., p. 10,929; see Appendix B to this Reply Brief and Pet. App. 520-522).

** Eng. Ex. 187, Pet. App., 799-800, adjusted as shown in Exhibit C to Petitioners' Brief before the Commission of March 16, 1942 (R., p. 10,929; see Appendix C to this Reply Brief and Pet. App. 747-753).

*** The evidence is clear on the point and is uncontroverted to the effect that the employees in other departments than transportation who are presently enjoying free transportation regard their free transportation as a part of their regular salaries, and, if the transportation properties were disposed of, they would reasonably insist that the Company adjust their compensation so as not to cause them to sustain loss in income by reason of such disposition. The evidence shows that the value of this privilege to these employees is about \$5 per month. The testimony of Petitioners' witnesses, Holtzclaw and Jones, is clear that if the transportation department of Virginia was disposed of the Company would have to make an adjustment in the employee's compensation correspond-

But Respondent disregards the fact that Petitioners' witness Barnes, in presenting Petitioners' evidence with respect to the increment value of the Virginia transportation business of Petitioners, has in effect assumed that any purchaser of the transportation business would pay a correspondingly greater price for such properties in view of the increased revenue to accrue from employees presently riding on free passes, and, therefore, he has eliminated from the additional expense, estimated to be thrown on the electric department by divestment of the transportation business, the amount of the free transportation credit (\$94,000) as compared with the additional expense of \$108,550 charged to the electric department (Pet. App. 521). See also Appendix B to this Reply Brief.* Similar elimination was made in respect of El Paso. See Appendix C to this Reply Brief.

The basis for Respondent's criticism of the above item has been substantially eliminated as above shown, but the fact remains that the furnishing of free transportation by the transportation department to employees in all other departments without cash outlay by these other departments, and without any materially increased cost to the transportation department shown by the evidence, is a significant example of the many mutual advantages derived from joint operation.

Regarding Petitioners' estimates of increased expenses in Executive and Office pay roll which would have to be absorbed by the electric departments with respect to joint

ing to this value (Pet. App. 436-438, 449-450, 480-481, 504-508). Petitioners' witness, Nelson, President of El Paso, testified in the same connection regarding the necessity of making a similar adjustment in El Paso if the transportation properties were disposed of, saying, "Well, as a practical matter you just cannot tell employees nowadays what they must remember about this sort of thing" (R., p. 3187). Such adjustments were not made when the relatively small transportation systems of Beaumont, Texas, and at Baton Rouge, Louisiana, were sold in view of the small size of the businesses and the small extent of use there made.

* Likewise it appears on said Appendices B and C that the item of Pensions (\$40,000 in Virginia and \$7,270 in El Paso) has also been eliminated in the calculation of the increment value of these other businesses; so Respondent's objection on this point also disappears.

personnel on divestment of the transportation and toll bridge businesses (\$66,997 in Virginia and \$13,839 in El Paso), Respondent's argument that these increases should not be attributed to the divestment order because the services of the executive and other joint employees would be required not by the present needs of the electric department but for its future expansion, is merely the repetition of a theory which was sought unsuccessfully to be maintained on cross examination of Petitioners' witnesses.* Respondent's arguments on the other items of increased expense are also in the face of the undisputed evidence to the contrary.**

It thus appears that after eliminating the questioned free transportation and pension items, a minimum saving from joint operation accrues to the Virginia electric system of more than \$100,000 (Eng. Ex. 228, Pet. App. 881 and 322 and Appendix B to this Reply Brief), and to the El Paso electric system of \$20,000 (Eng. Ex. 187, Pet. App. 360, 799, and Appendix C to this Reply Brief), which we submit is certainly relevant on this issue.

* It is true that at several points in the record Petitioners' witnesses conceded that, in connection with the expanding electric businesses, the executive personnel and other joint employees who would be relieved of their present duties to some extent by disposition of the transportation businesses would be able to use the time so released in connection with the future growth of the electric businesses, but, viewed as a whole, the testimony was clear from Petitioners' witnesses (who alone testified on the point) that the services of these executives and employees would be *immediately* required for the efficient operation of the respective electric systems as they exist at the present time (R., p. 1241; Pet. App. 747-748).

** Respondent's argument that, if petitioners' transportation businesses were disposed of there would be no increased expenses to be absorbed by the electric systems arising from the present jointly used facilities, such as jointly used poles, conduits, etc., is directly contrary to the uncontroverted evidence that any purchaser would convert to an all bus operation and thus not use such joint facilities (Pet. App. 482-483, 488-489, 494-495).

Respondent's argument that there would be no increased expenses to be absorbed by the electric departments arising from the discontinuance of jointly used office buildings, furniture, equipment and store rooms resulting from the severance of the transportation departments, is also not supported by the record, which shows that the real reason why such expenses would have to be absorbed is that most of the joint executives and employees performing services for both departments would have to be retained for the electric departments (Pet. App. 482-483, 488-489).

*Value of Transportation and Toll Bridge Investment to
Petitioners*

Appendices B and C to this Reply Brief showing Petitioners' basis for determining the value of these transportation and toll bridge businesses will specially aid the Court on this point (see also Pet. App. 519-525, 764-769).

Respondent urges that Petitioners' valuation of these businesses is based upon an unsound hypothetical contention which assumes that the income from these transportation and toll bridge properties is worth more to the Petitioners than to a purchaser, and Respondent speciously contends that a sufficient answer to Petitioners' evidence regarding value is that "there is no reason why a purchaser could not realize it as well" (Res. B. 46).*

As shown in Petitioners' Main Brief (Res. B. 79-82; 114-115) the amount of salvage which can be procured per

* Here, again, Respondent's argument is in the teeth of the uncontroverted evidence presented by Petitioners' witnesses, principally Mr. Barnes, an expert of wide experience in such matters, who testified that, after a thorough investigation of the matter, he found that the only sales of such properties that had been made in recent years were to purchasers who proposed to convert to "all bus" operation (Pet. App. 530-533); that it was only on this basis that public financing could be done; and that in his considered judgment no purchaser could be found who would run the risk of being unable to finance at least part of the purchase price by the issuance of securities to the public, or through the medium of a bank loan (Pet. App. 529-536).

The argument that perhaps some individual or municipality might purchase the transportation properties without any public financing being involved does not in the slightest degree support the contention that such a purchaser would pay a higher price than a purchaser who required such financing, as it is not to be presumed that anyone would be interested in freezing in any such purchase an amount which could not be realized through public sale of the property or who would pay more for the property than its value as shown by the market. It is not uncommon for a business to be worth more to the present owner than any one else, particularly by reason of its joint operation with another business and the economies incident thereto. Respondent's approach to this problem is in utter disregard of the fact that there is a vast difference from the investor's point of view in his being already engaged in the transportation and toll bridge businesses jointly operated with an electric business rather than about to invest. The uncontroverted evidence in the record shows that the street railway portion of the transportation business is a drug on the market; it is not saleable at all; whereas to the investors who now have their money invested in the business it cannot be doubted from the evidence in the record that the street railway properties and businesses have a salvage value to them far in excess of present market value if the present owners are allowed a reasonable length of time in which to carry out the salvaging operation (Pet. App. 529-536).

year from the Virginia transportation business is \$746,000*, which means that each year which Petitioners are allowed to continue this transportation business they will receive in cash from that operation an amount equal to about *one-fourth* of the sales realization value of \$3,103,000. In the case of El Paso transportation and toll bridge businesses the amount of salvage which can be procured per year is \$177,000, which means that each year which the Company is allowed to continue these businesses it will receive in cash from that operation an amount equal to about *one-sixth* of the sales realization value of \$985,000.

Alleged Abuses:

Respondent urges in conclusion that there have been certain past abuses in connection with the combined operation of the electric systems and transportation businesses which justify the Commission's divestment order. These alleged abuses are: " . . . there has been no proper segregation of railway and electric property between the respective plant accounts . . . there has been no segregation of depreciation accrual among the respective operations . . . there have been continued improper allocations of charges for joint and interdepartmental services . . ." (Res. B. 46-47). It has been shown in Petitioners' Main Brief that there is no reasonable ground to support this contention.**

* The comparison made by Respondent in footnote 60 (Res. B. 46) of the 6% rate at which the annuity value of the transportation income to Virginia is computed with the 16 $\frac{2}{3}$ % rate at which the sales price of the transportation business is determined, is confusing and misleading, as the comparison is not between like things. The 6% interest factor which Petitioners applied in determining the value of the transportation properties to Petitioners was the rate of return *after* depreciation earned by the investment in its electric system on the increment cash presently available from the retention of the transportation operation, which included as the principal item depreciation; the return of 16 $\frac{2}{3}$ % was based on the net income from Petitioners' transportation operations *before* depreciation (R., p. 3248).

** As pointed out in Petitioner's Main Brief (Pet. B. 84-85) this argument is addressed entirely to alleged past abuses and rests in no way on the contention that any of these alleged abuses are presently continuing or are likely to arise again.

The absence of complete segregation of electric and railway property into their respective property accounts is not peculiar to Petitioners. It is a matter of common knowledge that, in accordance with orders of the Federal Power

Summary

The Commission has itself been inconsistent in its application of the two other business clauses in like situations, allowing the retention of the transportation businesses with the associated electric businesses in the American Water Works and Electric Company case but refusing to permit continued joint operations in Virginia and El Paso. In view of the long historical operating relationship between the transportation businesses and the related electric businesses of the companies here affected, the electric businesses being an outgrowth of the respective street railway businesses, the clearly established economies resulting from joint use of personnel and facilities in each case, the transportation business not being a burden on the electric business in each case, and since the retention of the transportation business will conform to the desires of local public authorities in each case and will enable Petitioners to sal-

Commission under the Federal Power Act, as amended by the Public Utility Holding Company Act of 1935, Petitioners, as all other utility companies similarly situated, are presently engaged in studies under the direction of the Federal Power Commission, which will develop the basic facts showing the segregation of the electric properties from Petitioners' other property. When these studies are completed and appropriate orders are entered by the Federal Power Commission, the electric and other properties will be segregated into the appropriate departments.

It is also common knowledge that, under the requirements of the Federal Power Commission, the segregation of depreciation accrual between respective departments will have to be made as soon as the necessary studies have been completed.

As to the argument that there has been improper allocation of charges for joint interdepartmental services, it was certainly conclusively demonstrated in this proceeding that it is possible for joint expenses of the electric and transportation departments to be fairly and equitably allocated. This is just what was done by Messrs. Lybrand, Ross Bros. & Montgomery in their report with respect to Virginia (Eng. Ex. 202; Pet. App. 802). Since July 1, 1942, expenses have been apportioned accordingly by direction of the Board of Directors of Virginia (Pet. App. 536). Similar studies were made with respect to the other companies by the chief accounting officers in the light of Lybrand's analysis, modified in each case as local conditions indicated (Pet. App. 633-634, 690-694, 717). The evidence presented by the officers of the operating companies shows that studies are continually being made with a view to making such adjustments as are required from time to time in order to keep such allocations on a sound and equitable basis. The record shows that not until this case was begun had any occasion arisen for any over-all critical analysis of departmental allocations of expenses of Engineer's subsidiaries to be made, but when the question was properly put in issue, Petitioners proceeded to have the studies made as referred to above. The suggestion (Res. B. 47) that, despite new methods of allocation, improper allocations are to any extent still continuing is not borne out by the record (Pet. App. 538).

vage millions of dollars invested in these properties rather than dispose of them at a great sacrifice, it is submitted that because of the lack of substantial evidence to support the Commission's findings the Court should set aside the Commission's order requiring divestment of these businesses.

VII.

As to the Gas and Water Properties of Gulf and the Baton Rouge Bus Properties.

The Commission Erroneously Ordered the Divestment of the Gas and Water Properties of Gulf and the Baton Rouge Bus Properties.

Respondent does not undertake to justify on the merits that part of the Commission's order which directed the divestment of the gas and water properties of Gulf and the Baton Rouge Bus properties, but relies solely on the contention that the Commission's so-called "advisory findings" (Pet. App. 122-126, 129-134) "were never incorporated into an order", and, therefore, under Section 24(a) the question as to the retainability of these properties is not before this Court (Res. B. 48).

Respondent's error on this issue is apparent on the face of the record. In the Commission's order of September 16, 1942 here under review, the Commission specifically directed in Section 1 thereof that Engineers "sever its relationship with the companies named hereafter by disposing or causing the disposition . . . of its direct and indirect ownership, control and holding of securities issued and properties owned, controlled or operated by the following companies . . . Gulf States Utilities Company, Baton Rouge Bus Company, Inc. . . ." (Pet. App. 160). While it is true that the Commission provided that Engineers might within 15 days from the date of the order (extended later for an additional 15 days) petition the Commission for leave to retain as its principal system the electric util-

ity system of Gulf rather than Virginia, no such petition having been filed, the order of September 16, 1942, remains in full force and effect directing complete divestment of the properties of Gulf and Baton Rouge Bus.

This action of the Commission is closely related to the Commission's improper attempt to control Engineer's choice of the single system discussed in IV of Petitioners' Main Brief (Pet. B. 44-47 and in III of this Reply Brief).

The choice between Virginia and Gulf was, as the Commission found, "a close one" (Pet. App. 277-278). As argued in Petitioners' Main Brief and in this Reply Brief, it was error for the Commission to attempt to limit the time within which this choice was to be made to either one or two fifteen day periods. The Commission's present argument, however, makes its own error even more patent; for if it be true that the so-called "advisory findings" as to the properties and businesses retainable with Gulf were never "final", then even the limited choice purported to be afforded by the Commission to the Petitioners is wholly illusory. This would be true because in that case Petitioners, even during the limited time allowed by the Commission, had no final ruling from the Commission as to what other properties and businesses could be kept along with Gulf. Certainly, even under the Commission's theory, Petitioners were entitled to have a final Commission ruling on this issue before being required to make the choice which the Commission purported to allow them. In other words, even during the limited time allowed by the Commission, Petitioners were obviously entitled to have offered to them a true alternative between two choices as to scope of each of which final and complete administrative action had been taken. This was true as to Virginia, but the Commission is now contending that the other alternative, *i. e.*, as to Gulf, had not been presented to the Petitioners with final administrative action as to what could be retained with Gulf. This should not be permitted; the Commission's order and findings in this respect must be deemed "final" for the purposes of review.

This being so, and the Respondent having made no argument of substance on the point, in practical effect, all of Petitioner's arguments on the merits regarding the propriety of the Commission's order of divestment as to these properties remain unanswered.

Under the decisions of the United States Supreme Court in *Rochester Telephone Corp. vs. United States*, 307 U. S., 125 (1939), and *Federal Power Commission vs. Pacific Power & Light Co.*, 307 U. S., 156 (1939), the failure of the Commission to find that the Gulf gas system, the Gulf water business and Baton Rouge Bus properties may not be retained with Gulf is clearly a reviewable order under Section 24 of the Act. In the recent case of *Columbia Broadcasting System, Inc. vs. United States*, 316 U. S., 407 (1942), in considering the question as to whether or not a general regulation issued by the Federal Communications Commission there under review could fairly be regarded as an "order", the Court said (p. 416):

"The particular label placed upon it by the Commission is not necessarily conclusive, for it is the substance of what the Commission has purported to do and has done which is decisive. (Citing cases.)"

In accordance with the above principle, the Court should treat the advisory findings of the Commission in respect of the Gulf gas system, Gulf water business and the Baton Rouge bus properties, viewed in the light of the Commission's Findings and Opinion of September 16, 1942, as final and should set aside the order insofar as it directs divestment of these properties for the reasons set forth in Petitioners' Main Brief (Pet. B. 94-107).

Submission.

We submit that the orders under review should be set aside.

Respectfully submitted,

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Of Counsel.

Dated May 10, 1943.

Appendix A.

Analysis of Proffered and Excluded Evidence Bearing on Constitutional Issues.

The Witness and his Qualifications.

Dr. Merwin H. Waterman, economist, Professor of Finance in the School of Business Administration at the University of Michigan, was the witness whose testimony was proffered and excluded. Dr. Waterman graduated from the University of Michigan in 1925 with a degree of B. A. and took degrees as Master of Business Administration in 1926 and of Ph. D. in 1932 from that University. He has taught in that University from 1926 to date. He was an Instructor of economics and business administration from 1926 to 1929. In 1929 he became an Associate Professor of Finance in the School of Business Administration and continued as such until 1936; he was an Associate Professor of Finance from 1936 to 1941, and in 1941 he became Professor of Finance. During this period of association with the University of Michigan he acted as Research Assistant in the Bureau of Business Research during the summers of 1927 and 1928, and as Research Associate in the Bureau of Business Research during the summers of 1929 and 1930, and as Assistant Director in the Bureau of Business Research throughout the years 1930 to 1937 inclusive, and during the summer of 1940. He has acted as Secretary of the School of Business Administration of the University of Michigan from 1937 to date. The Bureau of Business Research mentioned is a division of the School of Business Administration and this school is a graduate unit of the University of Michigan. He has written a number of magazine articles and two books dealing with public utilities (Pet. App. 895-6). The statistical studies made as a basis for his testimony bore directly on a previous research which Dr. Waterman had done (Pet. App. 905-6).

In preparing the material for the proffered evidence, in supervising the work Dr. Waterman used all the time he

could spare from his regular duties at the University of Michigan between August, 1940 and May, 1941 and kept two competent statisticians busy full time and in addition used part time assistance of several other workers (Pet. App. 905). In addition, as stated below, the tabulations required were done by the punch card (Hollerith) machine tabulating equipment. That work was done by the highly trained technical staff at the Sorting and Tabulating Machine Station of the University of Michigan, supervised by the department head who directs all similar work passing through that station (Pet. App. 920-922).

Purposes of Act.

Counsel for respondents outlined to Dr. Waterman that in their opinion the ultimate or fundamental objectives of the Act were the protection of consumers of electricity and gas and the protection of investors in utilities; and they expressed the view that all of the abuses which the Act sought to correct and all the purposes sought to be accomplished thereby, were directly related in varying degrees to six factors, affecting either the public served or the investor in utility securities or both. Said six factors were as follows: (1) the cost of electricity and gas to consumers; (2) economy of management and operation of operating companies; (3) economy in raising capital for and financial management of utilities; (4) protection of investors in utilities; (5) effectiveness of regulation of utilities; and (6) adequacy and efficiency of service by utilities (Pet. App. 901). These six factors are not mutually exclusive but overlap each other and some are means to desired statutory ends rather than ends in themselves. Thus there is nothing in the Act to indicate that "effectiveness of regulation" was sought as an end in and of itself, but rather it was sought as a means of achieving the fundamental objectives of the Act, namely protection of consumers of gas and electricity and protection of investors in the securities of utility companies. Similarly, economy of management and operation, economy in financial management, and adequacy and efficiency of service, were sought

to be achieved by the Act not so much as objectives to be desired in and of themselves but rather to the ultimate end of protecting consumers and investors. The most important of the six factors was the cost of utility service to consumers, since factors such as economy of management and operation, economy in financial management, effectiveness of regulation, and adequacy and efficiency of service, all tend to be reflected in the cost at which electric and gas services are rendered to the consuming public (Pet. App. 902).

Counsel for respondent further outlined that Section 11 of the Act seeks to regulate the kind and character of holding companies that may continue to exist by restricting the size and relative geographic location of utilities which one holding company may continue to control. Accordingly, the regulatory devices of Section 11 may be said to involve (1) the character of control over utilities, (2) the size of operating utilities, both as separate integrated systems and as parts of holding company systems, and (3) the relative geographic location of the operating utilities in any holding company system (Pet. App. 903).

The specific request for the study is given below in Dr. Waterman's words:

"Stated in a rather general manner, I was asked to make an impartial and objective study to determine whether there is any relationship and, if so, what relationship, between the regulatory devices of Section 11 which I have mentioned and the statutory objectives which I have also mentioned. Stated in more detail, I was asked to make a study to determine whether there are any discernible economic disadvantages which are peculiar to (1) utilities which are controlled by holding companies, (2) utilities and utility holding company systems of large size, and (3) utilities which are related to each other geographically in a manner not permitted by Section 11.

"Thus, for example, my attention was called to the fact that Section 1 of the Act contains the suggestion, among others, that consumers have been forced to pay more for gas and electric services than otherwise would have been the case because some utility companies have been con-

trolled by holding companies; that some electric and gas rates have been maintained at unnecessarily high levels by reason of excessive service charges and excessive dividends required from subsidiary utility companies by holding companies; that some utility and holding company systems have become so large that they are unwieldy and inefficient with resulting higher rates and less adequate service to consumers and lower returns to investors. I was asked to undertake a study to determine whether these charges are generally true as applied to all holding companies, and whether the suggested economic disadvantages or evils are more generally associated with holding company subsidiaries than with independent utilities. To state it more accurately, I was asked to undertake a study to determine whether there is any evidence that the suggested economic disadvantages or evils are really a function of the fact, or have any real relation to the fact, that a utility is controlled by a holding company, or that a utility or a holding company system reaches a large size, or that utility units in a holding company system are not situated geographically with respect to each other in the manner required by Section 11'' (Pet. App. 903-4).

Sources of Data.

The primary source of data was the rate publications of the Federal Power Commission (FPC) which shows a list of 636 operating utilities constituting all companies which serve in each of 18,000 communities in the United States (which includes all communities of 250 population and over). This source also supplied data regarding size of company and size of community and also the data regarding rates charged for electrical service (Pet. App. 910-920).

Utility companies were classified as independent or as holding company subsidiaries in accordance with the Securities and Exchange Commission (SEC) list (Pet. App. 917). 182 were independent, 454 were subsidiaries of holding companies. SEC files also yielded information on size of

holding company systems and other data *re* holding companies and security issues (Pet. App. 918-919).

Moody's Manual was used in checking and interpreting some data taken from these sources and as prime source for certain figures (Pet. App. 918-919).

The 636 companies included in the tabulation furnish 95.62% of the total service furnished by private companies in the United States (Pet. App. 925).

Method of Statistical Tabulation.

As more fully explained above, punch cards (Hollerith) were used and standard machine tabulating methods, handled by experienced personnel. The rate data are built up by use of the average bills in each of the 18,000 communities studied, combined into averages by weighting by the size of the community (Pet. App. 920-924).

Determinations.

Dr. Waterman's report sets forth at some length the details and character of each of the numerous individual studies comprising said report, and shows as to each such study the precise steps taken and the comparisons made. None of said studies was predicated upon "selected" utilities or "selected" holding company systems. On the contrary, every test or comparison was predicated upon *all* the particular units in question in the United States in respect of which the requisite data were available (Pet. App. 917). It is possible in this summary to set forth only the general outline of the various studies and Dr. Waterman's conclusions with respect thereto.

I. Rates:

Dr. Waterman considered his determinations with respect to rates of service of primary importance because "the impact of all phases of economy in management and operation come to a focus in rates" (Pet. App. 960), and

because, if holding companies are now guilty of abuses, are too large or unwieldy, or if the distance of operating companies from general headquarters of the holding company has a bad effect, these factors should show in the rates being charged for service (Pet. App. 904).

Conclusions:

(a) There is a universal tendency throughout the country for holding company subsidiaries to sell electricity at lower rates than independent utility companies (Pet. App. 936, 942-943). This is essentially true no matter how the data are subdivided, whether by communities of various size groups (Pet. App. 937, 945-949), by operating companies of various size groups (Pet. App. 967, 974), or by geographical districts (Pet. App. 940, 950-958).

(b) Size bears a definite relation to level of rates. Rates are lower in larger communities, higher in smaller (Pet. App. 937, 945-949). Rates of large utility companies are lower than those of smaller utility companies (Pet. App. 974, 1035, 1044-1045).

(c) Rates of subsidiaries of large holding companies are generally lower than those of small holding companies (Pet. App. 1079, 1082).

(d) Level of rates of a holding company subsidiary has no statistical relationship to the distance of the operating property from general headquarters of the parent company (Pet. App. 1103-1104).*

II. Costs of Operation:

The second group of studies seeks to determine what relationship exists between economy of operation and the method of control of the operating company, its size and its relative geographic location to the general headquarters of its parent company if it is a subsidiary of a holding company. Conditions under which utilities operate vary widely and operating ratios are defective as measures of

* The rate determinations made are with respect to electric rates since Dr. Waterman was unable to find appropriate source data for gas rates (Pet. App. 907-908).

efficiency since they are more affected by investment ratios than by efficiency in operation (Pet. App. 961). Factors which can properly be compared as between utilities and which, as Dr. Waterman stated, “ * * * appeared most likely to have a relation to differences in efficiency as between independent utility operation and holding company subsidiary operation, if any such differences existed” (Pet. App. 960), were as follows:

(1) Executive expense or salaries paid to management, per \$1,000 of revenue.

(2) Expenses for management and administration, per \$1,000 of revenue.

(3) Fees paid for managerial service, per \$1,000 of revenue.

Conclusions:

(a) It has already been noted, in I above, that rates are lower for holding company subsidiaries than for independents, thus indicating greater overall efficiency of operation. Executive expense averages nearly three times as high for independent companies as it does for holding company subsidiaries (Pet. App. 973). Administrative and general expenses (including management fees) averages 18% higher in independent companies than in holding company subsidiaries. Administrative and general expenses average 20.24% of total operating expenses for independents against 16.02% of total expense for holding company subsidiaries. Management fees average less than 3% of total operating expenses (Pet. App. 973). Thus, available evidence as to management and operation indicates that independent utilities are not operated as economically as holding company subsidiaries (Pet. App. 972).

(b) Larger companies are operated in some respects more economically than smaller companies and “There is no evidence that increases in the size of operating companies are accompanied by sacrifice in economy of management and operation” (Pet. App. 1053-1055). These state-

ments are equally true if independent companies and holding company subsidiaries are segregated and treated as separate groups (Pet. App. 1056-1057).

(c) It does not appear that there is any definite relationship between size of the holding company system and economy of management and operation. "There is certainly no evidence that the economy of management of holding company subsidiaries tends to be affected adversely as the size of the holding company system increases; such evidence as there is on the point being to the contrary" (Pet. App. 1089-1090).

(d) As to the relative geographic location of operating subsidiaries with respect to general headquarters of the parent company, there is no evidence which "by any stretch of the imagination, could be taken as measuring a significant relationship between such distance factor and the economy and efficiency of the management and operation of the operating company" (Pet. App. 1112-1113).

III. Economy in Raising Capital for and Financial Management of Utilities.

The factors, considered to be indices of sound financial management, compared in this section are first, the cost of capital (bond money and preferred stock money) and second, the policy of the management in retention of earnings to build up the property as contrasted with the payment of a greater proportion of the earnings in dividends (Pet. App. 976). (The second factor is directed particularly toward the charge in Section 1 of the Act that holding companies paid "excessive dividends" and stripped the operating companies of cash needed for construction.)

Conclusions:

(a) There is no significant difference in the respective costs of bond money to holding company subsidiaries and to independent utilities (Pet. App. 985). "there certainly is no basis for the belief that in recent years independent utilities have enjoyed any advantage over holding com-

pany subsidiaries either in the matter of money costs or the costs of raising capital" (Pet. App. 987). Data regarding the costs of raising preferred stock capital during the period studied are meager, but such data as there are show no significant differences as between the cost of money to holding company subsidiaries and independents (Pet. App. 986-988). "Although the holding company subsidiaries distribute slightly more of their income to bondholders and preferred stockholders than do the independents, in the administration of residual income the holding company subsidiaries appear to be more conservative than the independents" (Pet. App. 989, 1001). Thus, holding company subsidiaries retained 45.1% of the common stock earnings, while independent companies retained but 30.8% (Pet. App. 1001).

Holding companies supplied over \$100,000,000 of common stock equity to over 70 of their operating subsidiaries during the two years 1939 and 1940. During the same period only one independent utility made any significant increase in its residual equity capital (Pet. App. 995, 1002-1007). "It rather clearly appears that holding companies provided a source of equity funds for small subsidiaries which was not matched in any way for the small independent utilities" (Pet. App. 996). "There are no significant overall differences between independent utilities and holding company subsidiaries on the score of sound and efficient financial management" (Pet. App. 996).

(b) The cost of raising bond and preferred stock money decreases as the size of the issuing company increases. " * * * large issues of large companies are more acceptable to investors because of greater marketability" (Pet. App. 1060-1061). The SEC has issued statistical studies indicating the same conclusion (Pet. App. 1059-1060). There is no indication of a direct relationship between size of operating companies and sound and efficient financial management (Pet. App. 1064).

(c) "there is no real relationship between the size of a holding company system as such and the soundness of the

financial management of the operating companies in such system" (Pet. App. 1094).

(d) Geographic location of operating subsidiaries with respect to the general headquarters of the parent has no relationship whatever to quality of financial management or the cost of money (Pet. App. 1094).

IV. Protection of Investors.

These factors were studied by analyzing the usual ratios employed by analysts, namely, interest coverage and percentage of revenues remaining after interest payments.

(a) On the average, independent utilities have a better interest coverage than holding company subsidiaries (Pet. App. 1013). However, the averages for independents are greatly affected by a group of issues with exceedingly high coverage which does not carry a corresponding increase in protection to investors (Pet. App. 1014). After further analysis, Dr. Waterman concludes that "no investment analyst could properly conclude that the bonds of independent utilities as a whole tend to be better than those of holding company subsidiaries or that holding company subsidiary bondholders as a group tend to be accorded less protection than independent utility bondholders" (Pet. App. 1015-1019).

There is no consistent advantage accruing to preferred stockholders of independent utilities as compared with holding company subsidiaries (Pet. App. 1025): "if one were to invest in public utility securities at random he would have a better chance of getting a reasonably safe security if he made his choice from securities of holding company subsidiaries than if he made his choice from securities of independent utilities; * * *" (Pet. App. 1026). "* * * the fact that utility is controlled by a holding company has no tendency to cause the securities of such utility to be of less desirable character than would be the case if such utility were not so controlled by a holding company, nor does control by a holding company have any tendency to result in

less protection to the holders of the security of an operating utility than would otherwise be the case" (Pet. App. 1027).

(b) "there is no evidence that mere size of the operating company is a factor which in and of itself is related to either the protection of bondholders or the protection of preferred stockholders of operating utilities. * * * Of course it should be emphasized that this is a statistical conclusion based on averages. The basis forbids that the conclusion be applied to consideration of securities of individual companies since the use of averages brings in a diversity of companies within each size group; * * * " (Pet. App. 1071-1072).

(c) " * * * there is no relationship between the size of a holding company system as such and the character or quality of the investment protection afforded to holders of the securities of the operating companies in such system" (Pet. App. 1098).

(d) Geographic location of operating property with respect to headquarters of a parent company is not "related in any way to character and quality of protection accorded to the investors in the securities of such operating company" (Pet. App. 1121).

V. Effectiveness of Regulation.

As already noted "effectiveness of regulation" is not considered to be, in and of itself, an end or purpose of the Act but rather a means to the protection of rate payers and investors (Pet. Ap. 1123). There are no statistical yardsticks available to measure the effectiveness of regulation. Dr. Waterman took the most direct approach by obtaining the opinion of regulatory officials through a questionnaire and from a series of interviews with such regulatory officials (Pet. App. 1127).

Conclusions:

"there is no evidence that at the present time State regulation of management fees (charged to holding com-

pany subsidiaries) is less efficient or effective than State regulation of corresponding charges to independent utilities; certainly there is no reason why it need be less efficient and effective. Moreover, at the present time, so far as operating subsidiaries of registered holding companies are concerned, the regulation of management fees by the S.E.C. is clearly even more comprehensive and effective, by and large, than State regulation of the charges to independent utilities for management services" (Pet. App. 1129). The same applies to the quality of management service furnished (Pet. App. 1131).

There is no significant difference between holding company subsidiaries and independent utilities so far as cooperation with State regulatory commissions in the regulatory process is concerned (Pet. App. 1132). " * * * practically all the State commissions which were interrogated were quite satisfied with their ability to cope equally well with independent utilities and with holding company subsidiaries within the limits of their respective statutory jurisdictions" (Pet. App. 1132). " * * * there is no evidence whatever that holding companies and holding company subsidiaries interfere with or impede effective State regulation of financial matters to any greater extent than independent utilities" (Pet. App. 1133). State regulation of holding company subsidiaries is at the present time as efficient and effective as state regulation of independent utilities. "It is true that the attitude of some holding company systems with respect to public regulation are not beyond criticism, but the same is equally true of the attitudes of at least a proportionate number of independent utilities" (Pet. App. 1135).

If the operating subsidiaries of the respondent should be removed from the regulatory jurisdiction of the SEC by the enforcement of Section 11(b)(1), these subsidiaries "will thereafter in many cases be less effectively and less efficiently regulated than they now are" (Pet. App. 1136).

Appendix B.

Revision of Engineers Exhibit 128

Adjusted 1. By report of Lybrand, Ross Bros. & Montgomery 8/1/41
(Engineers Exhibit 202)

2. To remove pension expense from Purchaser's operating costs
(R., pp. 3262-3263)

VIRGINIA ELECTRIC AND POWER COMPANY

Value of Transportation Business

Thousands of Dollars

	Engineers Exhibit 128	Revision by Lybrand Report of 8/1/41 Engineers Exhibit 202	Revision Re- sulting from Elimination of Pension Expense from Purchaser's Operating Cost (3262-3)
I If operation by Vepco continued at 1940 level for 15 years			
Gross income—Lybrand re- port 5/1/41	\$ 113	\$ 106(a)	\$ 106
Accrual for Railway depre- ciation	\$ 583		
Estimated annual replace- ments	<u>50</u>		
Depreciation accrual avail- able for return of capital..	533	533	533
Estimated expenses now borne by and services fur- nished by transportation department which would have to be borne by other departments if transporta- tion were sold.....	\$ 244	\$249(b)	
Less Federal income tax sav- ing	<u>44</u>	<u>46(c)</u>	
	200	203	203
Transportation and Advertis- ing furnished other depart- ments—not cash revenue	<u>96*</u>	<u>96*</u>	<u>96*</u>
Annual incremental cash from transportation operations....	750	746	746
Present worth @ 6% of an- nuity of \$750 for fifteen years (9.712)	7,284	7,245	7,245
Present worth of business for sale 15 years hence @ \$2,110 value determined below (.4173)	<u>880</u>	<u>875(d)</u>	<u>970(e)</u>
Total present worth to Vepco	<u><u>\$8,164</u></u>	<u><u>\$8,120</u></u>	<u><u>\$8,215</u></u>
II If sold by Vepco			
Net operating revenue be- fore depreciation—Lybrand 5/1/41	\$ 935	\$ 931(f)	\$ 971(g)
Value fully converted to bus operation estimated at 6 times above earnings.....	5,610	5,598	5,825
Cost of converting railway to bus, 325 buses.....	\$2,500		
Abandonment expense; paving etc.	<u>1,000</u>	<u>3,500</u>	<u>3,500</u>
Estimated market value.....	<u>2,110</u>	<u>2,098</u>	<u>2,325</u>
Estimated Federal Income Tax saving to Vepco if sold in 1941 if tax rate is 30%	<u>842</u>	<u>846(h)</u>	<u>778(i)</u>
Estimated sales realization....	<u><u>\$2,952</u></u>	<u><u>\$2,944</u></u>	<u><u>\$3,103</u></u>

* Indicates red.

See notes on following page.

NOTES TO REVISION OF ENGINEERS EXHIBIT 128

- (a) Gross income revised by Lybrand report of 8/1/41 (Engineers Exhibit 202).
- (b) Expenses to be borne by Electric Department in case Transportation is disposed of increased by Lybrand revision.
- (c) Federal Income tax saving adjusted on account of the change in estimated increased expenses to the Electric Department in case Transportation Department is separated.
- (d) Adjustment in this figure caused by Lybrand revision, which reduces the estimated market value from \$2,110,000 to \$2,098,000. The present worth is correspondingly reduced.
- (e) Adjustment in this figure arises from the increase in estimated market value to \$2,325,000 due to removing pension expense from the operating costs of the purchaser of the transportation system. This figure is the present worth on a 6% basis of the \$2,325,000 market value.
- (f) This figure is taken from Engineers Exhibit 202, being the sum of \$106,000 net operating revenue after depreciation plus \$825,000 depreciation.
- (g) This figure is derived from the figure noted in (f) above by adding back the \$40,000 pension expense which would not have to be deducted in the purchaser's operating expenses.
- (h) The reduction in estimated market value increases proportionately the tax saving which would be realized by the Virginia Company.
- (i) The increase in estimated market value decreases proportionately the Federal Income tax saving to be realized by the Virginia Company.

Appendix C.

Revision of Engineers Exhibit 187

Adjusted to remove pension expenses from
purchaser's operating costs (R., pp. 3262-3263)

EL PASO ELECTRIC COMPANY (DELAWARE) AND SUBSIDIARIES

Value of Transportation Business
Thousands of Dollars

	Engineers Exhibit 187	Revision resulting from elimination of pension expense from purchaser's operating cost (3262-3)
I. If Operation by Company continued at 1940 level for ten years		
Gross income—Engineers Exhibit 176.....	\$ 82	\$ 82
Accrual for Railway and Bridge Depreciation....	\$101	
Less estimated accrual for bridges.....	12	
	<u>89</u>	
Accrual required for bus replacements after substitution of buses for Fort Bliss Line (after 1944)	14	
Depreciation accrual available for return of capital	75	75
Estimated expenses and charges now borne by transportation department which would have to be borne by the electric department if transportation were sold.....	29	
Less Federal income tax saving.....	9	20
Annual increment cash from transportation operations	177	177
Present worth @ 6% of 177 for 10 yrs. (7.36)	\$1,303	\$1,303
Present worth of business for sale 10 yrs. hence @ \$902 value determined below (.56).....	505	529(a)
Total present worth to El Paso Electric Company (Delaware)	<u>\$1,808</u>	<u>\$1,832</u>
II. If Sold by Company		
Net operating revenue before depreciation—Engineers Exhibit 176.....	207	214(b)
Value fully converted to bus operation estimated at 6 times above earnings.....	1,242	1,284
Cost of converting to bus operation		
Buses	360	
Garage	75	
Abandonment expense net.....	42	477
Total market value.....	765	807
Net current assets El Paso and Juarez Traction Company	137	137
Estimated market value.....	902	944
Estimated Federal income tax saving if sold in 1941 if tax rate is 30%		
a. El Paso and Juarez Traction Co.		
Value of property $\frac{765 \times 47}{207}$	174	177(c)
Net current assets.....	137	137
Total market value.....	311	314
Tax cost of El Paso (Delaware).....	311	311
Tax saving to El Paso (Delaware)	0	3(d)
b. El Paso Electric Company (Texas)		
Tax base transportation assets.....	771	771
Sale price " 765—174.....	591	630(e)
Tax loss "	180	141
Tax saving 30%.....	54	42
Estimated sales realization.....	<u>\$ 956</u>	<u>\$ 985</u>

See notes on following page.

NOTES TO REVISION OF ENGINEERS EXHIBIT 187

* Deduction.

- (a) Present worth of business for sale 10 years hence @ \$944,000 value determined in II (.56).
- (b) Net operating revenue adjusted by adding \$7,000 of pension expense which would be assumed by electric department and therefore would not be an expense to purchaser in his operating expenses.
- (c) Value of property of El Paso and Juarez Traction Company is $\frac{47,000}{214,000} \times 807,000 = \$177,000$.
- (d) Taxable gain which results in increased taxes of \$1,000.
- (e) Sale price of Texas properties $\$807,000 - \$177,000 = \$630,000$.

